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FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION RECAPITALIZATION ACT OF 1987

CIS RECORD ONLY:

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE-HUNDREDTH CONGRESS

FIRST SESSION

MARCH 3 AND 4, 1987

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION RECAPITALIZATION ACT OF 1987

TUESDAY, MARCH 3, 1987

House of Representatives, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Committee on Banking, Finance and Urban Affairs,

Washington, DC.

The subcommittee met at 10 a.m. in room 2128 of the Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of

the subcommittee) presiding.

Present: Chairman St Germain, Representatives Hubbard, Barnard, LaFalce, Vento, Roemer, Kaptur, Gonzalez, Morrison, Erdreich, Carper, Torres, Kleczka, Patterson, McMillen, Price, Kennedy, Wylie, Leach, McKinney, Shumway, Wortley, Dreier, Parris, Roukema, Bereuter, Bartlett, Roth, Hiler, McCandless and Saxton.

Chairman St Germain. The subcommittee will come to order. This morning, we continue hearings on plans to recapitalize the

Federal Savings and Loan Insurance Corporation.

As this committee in the House stated in the last Congress, the FSLIC fund must be replenished. It is important that the savings and loan regulatory structure have flexibility in dealing with ailing institutions. And it is equally important that we maintain the confidence of the millions of depositors nationwide.

When we opened these hearings January 2l, I stated, and I quote: "If the plan does become law, the Congress should be sure it maintains tight and ongoing oversight to make certain that the word 'flexible' does not become synonymous with arbitrary, capri-

cious or wasteful."

I reemphasize that position this morning. We need a regulatory and insurance structure properly funded and infused with a heavy dose of common sense. It is possible to protect the FSLIC fund and nurture this industry back to health without regulatory chaos.

Plain, every day, garden variety common sense will do wonders. Much talk is centered around an ill-defined term, "forbearance". Essentially, what is being asked is that there be a regulatory policy which allows otherwise healthy savings and loans to survive despite sharp downturns in areas such as Texas and the agricultural communities.

But, we cannot let forbearance stretch to protect the mismanaged or terminal cases that would only serve to further drain the FSLIC fund. Forbearance must be designed to help the well-managed institution temporarily on hard times. It must not be forgiveness for the speculators, the high flyers, and the fast buck artists.

There is also much support for reducing the size of the administration plan or at least requiring a periodic review by the Congress before the entire sum becomes available to FSLIC—the so-called short-leash approach.

This and other suggested modifications must be acceptable in the marketplace. The entire plan rests on the ability to sell bonds and we must keep that in mind as we consider changes in the structure. We must have a workable plan and one which can raise funds in the market at the least possible cost.

I hope we can obtain answers to the key questions during these hearings. We need a viable FSLIC recapitalization plan in place in

a timely fashion.

The chair now recognizes our ranking minority Leader, Mr.

Wylie.

Mr. Wylie. Thank you very much, Mr. Chairman. I, too, would like to welcome our distinguished panel this morning. And, in view of the events of the past weeks, I know we're going to have a lot of important questions for you.

As the Washington Post stated in an editorial last week:

"Of all the financial reforms that Congress needs to take up, the most urgent is refinancing FSLIC. If it wasn't clear to some last year, it certainly must be obvious by now that FSLIC recap is of

paramount importance."

The press reports last week that the GAO has decided that FSLIC must write off \$6.5 billion in expected losses, leaving FSLIC with a balance sheet \$3.8 billion in the red for 1986, underscores the urgency of needed action. And I should note that Mr. Wolf from the GAO will testify this morning that GAO has now determined that FSLIC needs to establish a contingent liability in the range of \$8 billion to handle cases that will require action in the near future.

As one who lived through a very serious crisis involving privately-insured thrifts in Ohio, in 1985, I, for one, can say that I don't want to see that experience repeated. And I'm sure my colleagues from Ohio and Maryland will agree with me. The need to act now to preserve public confidence in our Nation's thrifts is critical.

We cannot allow a small minority of troubled institutions to jeopardize the overwhelming majority of S&L's which are strong and vital providers of housing credit to millions of American consumers. Since last October, a number of questions have been raised concerning the scope of recapitalization as well as FSLIC's capabilities of effectively managing a large infusion of funds.

Questions have also been raised concerning Bank Board regulatory and supervisory policies. I am hopeful that this second round of hearings this year will enable us to resolve these concerns and

act on this critical legislation.

I am particularly interested in learning from our witnesses this morning their views on the policy statement on forbearance issued by the Bank Board last week. That policy closely parallels policies adopted by the bank regulators last spring.

Is this an appropriate response to the concerns of some thrifts that FSLIC recap may lead to the precipitous closing of many institutions?

These and many other questions will be of interest to me. And, again, welcome to our witnesses this morning.

Thank you, Mr. Chairman.

Chairman ST GERMAIN. The chair recognizes Mr. Barnard for a unanimous consent request.

Mr. BARNARD. I ask unanimous consent that my opening statement be included in the record.

Chairman St Germain. Is there objection?

[No response.]

Chairman ST GERMAIN. The chair hears none. Without objection. [The opening statement of Mr. Barnard can be found in the appendix.]

Chairman ST GERMAIN. Does anyone else seek to be recognized at this point, prior to my calling upon the witnesses?

Mr. BARTLETT. Yes.

Chairman ST GERMAIN. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman. And I'd offer just a couple of brief comments in preparation for this hearing, and my compliments to the chairman for the scope and the depth and the breadth of the witnesses that he's invited here today and for this week of the hearings.

A couple of comments. First of all, I think it's important that we all remind ourselves that nothing in either this legislation or other so-called forbearance or reform legislation would be designed to save those institutions that are so deeply insolvent that they both can't and shouldn't be saved or kept open.

In fact, what I hope to have happen, it appears that it is beginning to happen, is a combination of legislation including a combination of the recapitalization of the FSLIC with some basic regulatory reforms, so that those institutions that are so deeply insolvent that they ought to be, and have to be closed for the system will be in an orderly fashion.

But, those others—and that's the majority—that will be allowed to and provided a regulatory framework to work their way out of

the problems.

And, second, Mr. Chairman, even though the witnesses on the first panel here today are all from Texas, I think it's important to remind ourselves that this is not a Texas problem, or a problem

only in one section of the country.

Indeed, the U.S. League has testified that there are at least 12 States in similar circumstances, perhaps not as celebrated, but, nevertheless, the deep economic decline; and that it is a national problem in that the Federal Deposit Insurance of FSLIC applies to depositors all over this country. And this Congress, I think, is on the road towards making certain that we insure depositors in Connecticut as well as in Texas and Kentucky, as well as in California.

A great deal I think has changed in the sense of all sides seem to be coming toward the conclusion that some type of forbearance and reform legislation is required to be included in the recapitalization

effort.

The Federal Home Loan Bank Board has indicated their own package of proposals last week, which I welcome. And the Treasury has indicated their support for some of the proposals in H.R. 1063.

So I think great progress has been made. And I look forward to the hearing today and this week, and then to work with the chairman and other Members of the committee to refine the legislation and to move to a timely markup and put the legislation on a fast track.

I thank the chairman for the time.

Chairman St Germain. The chair wishes to assure the gentleman from Texas that those of us who were the original 13 States have indeed accepted Texas into the Union, wholeheartedly.

[Laughter.]

There being no further opening statements, we will now proceed to our third panel, comprised of L. Linton Bowman III, who is Commissioner of Texas Savings and Loan Department, from Austin, TX, and not an unfamiliar witness before this subcommittee; Mr. Walter McAllister—are you the third as well?

Mr. McAllister. Yes.

Chairman St Germain. My gracious. [Laughter.]

President of Texas—I didn't know Texas was in the Union that long. [Laughter.]

Texas Savings and Loan League, and chairman of the Forbear-

ance Committee of the U.S. League of Savings Institutions.

Mr. Roy Green, President, Federal Home Loan Bank Board of Dallas, Dallas/Fort Worth, TX, also a gentleman who has testified before us on numerous occasions in his former life.

And, H. Joe Selby, Director, Regulatory Affairs, Supervisory Agent, Federal Home Loan Bank of Dallas, Dallas/Fort Worth, TX. Is this the first time you've come before us with your new hat?

Mr. Selby. Yes, it is, Mr. Chairman.

Chairman St Germain. No longer the Comptroller's hat?

Mr. Selby. That's correct.

Chairman St Germain. By golly. Mr. Barnard says the hair stays the same color. [Laughter.]

Mr. Selby. It may fall out. [Laughter.]

Chairman ST GERMAIN. Our first witness will be Mr. Bowman. We will put your entire statement in the record, and you may proceed.

STATEMENT OF L. LINTON BOWMAN, III, COMMISSIONER, TEXAS SAVINGS AND LOAN DEPARTMENT, AUSTIN, TX

Mr. Bowman. Thank you, Mr. Chairman. For the record, my name is L.L. Bowman. I'm Commissioner of the Texas Savings and Loan Department. I appreciate the opportunity to appear before yourself and the Members of the subcommittee, particularly speaking on H.R. 27, the chairman's bill, entitled Federal Savings Loan Insurance Corporation Recapitalization Act of 1987; and on H.R. 1063, introduced by Mr. Bartlett, with three co-sponsors, entitled The Thrift Forbearance and Supervisory Reform Act.

My comments in regard to H.R. 27 will be general, and then I

will have more specific comments in regard to H.R. 1063.

And with the committee's indulgence, I will paraphrase my text

in the interest of brevity.

First, let me say I am in full support of efforts to recapitalize the insurance fund administered by FSLIC. The form of recapitalization and the amount of recapitalization is certainly important, but I do not view it a my role as a State regulator to try to influence those issues.

Obviously, the FSLIC must be recapitalized in the very near future if the extensive problems facing the savings and loan indus-

try nationwide are to be dealt with effectively.

One specific concern I would like to express in regard to H.R. 27 is with respect to section 7, which apparently makes the Federal Asset Disposition Association subject to certain audit reporting and open meeting requirements under Federal law.

My concern is that such provisions might operate to seriously hamper the effectiveness of FADA in dealing in a businesslike fashion with the extensive real estate holdings which it now has or

is likely to have in the future.

Making FADA's operations and records subject to public disclosure would, in my opinion, tend to undermine their ability to effectively negotiate the best business result with regard to specific assets.

Regarding Mr. Bartlett's bill, I am in favor of the forbearance measures contained in section 2 of the bill. Amortization of loan losses, the use of generally-accepted accounting principles in accounting for problem loans and restructured loans, and the use of general reserve accounts which are not charged against the Association's net worth are reasonable and worthwhile approaches to certain problems facing our industry.

The forbearance provisions of Mr. Bartlett's bill generally parallel those measures recommended by the subcommittee on regional problems of the U.S. League of Savings Institutions Task Force on FSLIC Issues, which was chaired by Mr. McAllister, on this panel today, and I also served on that subcommittee. And I support its recommendations, which Mr. Bartlett's bill seeks to implement.

I agree that loan losses or prospective loan losses which are the result of misconduct by an institution or its management should

perhaps not be subject to amortization.

But I would submit to the subcommittee that it consider the possibility of dealing with projects rather than institutions in determing its forbearance; because an institution which has been abused by an entrepreneur will have projects in its portfolio which are worthy and, in my opinion, deserve forbearance because, if for no other reason than because of the influence they will have on surrounding properties.

The fact that a particular project happens to be in a blighted area, but came from an association that was abused by entrepreneurs should not work against that project being given at least consideration for forbearance, because, in my opinion, otherwise, you will blight an entire area because of the decision to handle one

project at a time.

And on the other side of the coin, the recommendation is made that associations which are out of the State of Texas, which are out of the blighted areas, but have a substantial percentage of their portfolio involved in these project areas, should be granted forbearance.

Again, I would ask the subcommittee to please consider on a

project by project basis.

Because, if an Association in New York State has one project in South Houston that is blighted, that is not a substantial percentage of its assets but, nevertheless, that project still deserves consider-

ation for forbearance, in my opinion.

In regard to section 3 of the bill, entitled Improvements in the Supervisory Process, the review provision seems reasonable. And I have long been concerned about the apparent lack of an adequate appeal remedy for an institution under the classification of assets rule.

I also support the provision of the bill which allows flexibility in classifying loans and analyzing financial capability of borrowers, as

well as waiver of approval requirements.

I strongly favor the provision for allowing flexibility in requiring reappraisals of property acquired particularly through foreclosure.

I do not intend to require institutions under my jurisdiction to reappraise every piece of foreclosed real estate under State regulations.

It seems to me that under the current economic conditions, such reappraisals are counterproductive and are causing undue financial

and regulatory burdens to the institutions we regulate.

I am also in support of the provisions in regard to removing FSLIC from budgetary and personnel constraints. I believe FSLIC needs the ability to recruit top quality personnel, especially at the executive director and senior staff levels with the expertise needed to administer new funds properly.

There has been extensive turnover in the senior staff levels in the past 3 years at FSLIC. As a matter of fact, the present acting Director of FSLIC has just accepted a position as President of the

Des Moines Federal Home Loan Bank.

The agency needs the flexibility and independence to attract high quality staff. And the provisions in Mr. Bartlett's bill to ac-

complish this are very necessary.

Finally, I strongly favor the provisions in section 5 of the bill with regard to studying the feasibility of establishing asset acquisition corporations. A similar idea to establish such corporation in the State of Texas was subjected to several meetings around the State 2 years ago, when we brought this proposal to the Federal Home Loan Bank.

Unfortunately, their unwillingness to indemnify directors of that

corporation entered it into demise.

Finally, I wish to advise the subcommittee and the media that contrary to certain impressions which have been created by recent coverage of certain savings and loans events in Texas, I and my department staff enjoy good working relations with Mr. Green and the Federal Home Loan Bank of Dallas, and the Federal Home Loan Bank Board here in Washington.

No one should infer from the fact that there may be philosophical—occasionally philosophical—disagreements on how to handle a particular situation or the timing of certain actions, that the State

and Federal Regulatory authorities are not cooperating.

I intend to continue a good working relationship with our Federal counterparts. I was recently quoted in the Dallas media as being "absolutely against the closing of even the most insolvent associations in the State of Texas."

That is a misquote. What I did say was that:

"I will oppose the liquidation of the assets of associations in

Texas in the present environment."

Liquidation of assets and the closing of an association, placing it in receivorship or conservatorship are entirely different issues, and I do not oppose those actions.

I believe we all share the common objective of trying to weed out certain problems in the State and deal with the real estate problems at hand and seek to support a safe and sound savings and

loan industry in Texas and throughout the Nation.

We face some very, very difficult problems in the 2 to 3 years ahead. I look forward to a working relationship with Mr. Green and the Federal Home Loan Bank of Dallas, which is good and getting better, in dealing with these problems.

Thank you for your time and attention. If I can answer any ques-

tions, gentlemen, I'd be happy to do so.

[The prepared statement of Mr. Bowman can be found in the ap-

pendix.]

Chairman ST GERMAIN. Mr. Bowman, I think that you have stayed within your time period, and perhaps it would be wise to ask you to elaborate on a point, and therefore, you might facilitate the question and answer period.

Mr. Bowman. All right, sir.

Chairman ST GERMAIN. You just stated that you did not oppose closing an institution but rather what you opposed was the liquidation of assets in the present environment. Am I quoting you correctly?

Mr. Bowman. Yes, sir.

Chairman ST GERMAIN. I don't want to misquote you, now.

Would you just elaborate a little on what you mean by the

"present environment" for us?

Mr. Bowman. All right, sir. The main concern I have about appraisals earlier dealt with this same point. Projects in Texas, in certain areas of Texas, and I won't be that specific, we all know where they are, have little or no market value, particularly commercial projects. A part of the appraisal process indicates, dictates, as a matter of fact, that this lack of market value be influential in arriving at the appraised value of the property. If that property is appraised in its market value today, for example, a \$14 million project on South Padre Island was sold at auction last week for \$4 million. Eventually, in my opinion, either FDIC or FSLIC will suffer the \$10 million loss there. This is such a hostile environment, and there is so little market for most of this product that to try to quantify losses, either through appraisals or otherwise, today, in Texas, is counterproductive, and in my opinion, totally false.

We did not allow our institutions to appraise their assets up in the late 1970s and thereby create a massive net worth, nor should we now tell them to go back in in a historic low and appraise those projects down and take the resulting loss in net worth. So I think that liquidation, liquidation in this marketplace, which indicates a fire sale, if you will, would be disastrous to the economy in Texas, and I think it would have a ripple effect to other associations throughout the country that have brought product in Texas over the last 3 or 4 years during the peak of the Sunbelt mystique. There are associations today that I am aware of in the State whose liquidation would result in probably the failure of some 50 institutions nationwide. This is the sort of thing we—

Chairman ST GERMAIN. Sounds like Continental Illinois all over

again.

So you are referring primarily to the economic environment rather than to the regulatory environment?

Mr. Bowman. Yes. Absolutely.

Chairman ST GERMAIN. I think that perhaps what we should do at this point is have our next witness be Mr. Roy Green. In view of the fact that we have Mr. Bowman, who is the number one regulator for the State of Texas, we will have Mr. Roy Green, who heads up the regional office of the Federal Home Loan Bank in Texas, as our next witness. We will put your entire statement in the record. You may be recognized.

STATEMENT OF ROY G. GREEN, PRESIDENT, FEDERAL HOME LOAN BANK OF DALLAS, DALLAS/FT. WORTH, TX

Mr. Green. Thank you very much, Mr. Chairman.

It is a great pleasure for me to once again appear before this

very distinguished panel on this most important subject.

Our statement today will show that there is much to support the perception that a poor economy is the basis problem with many thrift institutions in the Ninth District; however, more must be added to the scenario to provide a complete picture. Specifically, there is a relatively small but significant number of institutions in our district that have abused their savings and loan charter. This group was characterized by excessive growth into high risk assets funded by high-cost liabilities. Management in these institutions generally had poor to nonexistent underwriting practices, inadequate disbursement controls and serious shortcomings in their recordkeeping. Characteristically, these high risk institutions have failed at a record rate and are primarily responsible for imposing extremely high and escalating costs on the FSLIC and the industry.

It is essentially that this group be separated and dealt with differently than those institutions that have actually been hurt by the economy. The deregulated environment made it attractive for thrift institutions to find new avenues for lending and investment. In the Ninth District, that strategy of extraordinary growth was easy to pursue. Many otherwise cautious businesses failed to take into account that all segments of the economy were cyclical. Many pursued activities in our region, as if there could be no downturn. Unfortunately, it was so attractive that some less principled entrepreneurs came in as well. Funds were diverted in some cases into their own pockets and a disaster was left in their wake.

One, among many suggested solutions to the solution, is to simply provide time for the economy to recover. It is certainly accurate that the current economy of the Ninth District is poor. The real estate market, both commercial and residential, has been drastically impacted with values down over 30 percent in some areas. A quick review of key financial figures for the District amply shows that a majority of thrift institutions have been adversely affected

by the economic conditions.

In 1986, regulatory net worth declined 51 percent. Loan delinquencies increased by 8.3 billions of dollars. And the overall return on assets declined 260 basis points. A recent study we conducted by our economics department of the bank segregated institutions of the Ninth District into four distinct categories. In this study, 58 percent of the institutions were determined to be well-managed and profitable. Twentyone percent of the institutions were determined to be well-managed but experiencing problems related to the economy. Twelve percent of the District institutions were considered to be troubled but with strong prospects of eventual recovery. Nine percent, including many of the opportunists mentioned, are considered to be nonviable. A major portion of this segment includes institutions already in the management consignment program.

Over the past $2\frac{1}{2}$ years we have directed much effort to the identification and containment of problem situations. Our supervisory efforts are now shifting to retainment of viable institutions and a continuation of a strong and prosperous thrift industry in the

Ninth District.

Mr. Joe Selby, Executive Vice President and Director of Regulatory Affairs of the Bank, will now present three cases from which—with your concurrence, Mr. Chairman, three specific cases from which specific references have been removed.

The first two illustrate severely troubled institutions in our District. The third shows what can be done in working with less troubled, well-managed cases that have suffered from economic condi-

tions.

[The prepared statement of Mr. Green can be found in the appendix.]

STATEMENT OF H. JOE SELBY, DIRECTOR, REGULATORY AFFAIRS, SUPERVISORY AGENT, FEDERAL HOME LOAN BANK OF DALLAS, DALLAS/FT. WORTH, TX

Mr. Selby. Mr. Chairman, if I might, I would like to just graphically go through the three cases that are in the statement and, hopefully, give you some perspective of the problems that we face in the Ninth District—

Chairman ST GERMAIN. We will put your prepared statement in

the record, and you may proceed.

[The prepared statement of Mr. Selby can be found in the appendix.]

Mr. Selby. Thank you.

Chairman ST GERMAIN. Without objection. Mr. SELBY. And perhaps some of the solutions.

The first association is one that was acquired in 1982 by an investor-developer. It was a rural S&L that moved to a metropolitan area and began a strategy of rapid growth. As you can see, an annualized growth of 1475 percent in the 3 years from December 1981

through December 1985. A \$29 million association that reached a limit of \$2 billion through the growth. This growth was, as President Green said, funded by volatile liabilities, high cost liabilities.

To use the growth, the asset shift went from the traditional low risk, 1 to 4 family mortgage lending, to the high risk ADC lending. Unfortunately, the growth was underpinned by very poor underwriting standards, very serious deficiencies in the lending policies.

Chairman ST GERMAIN. For the benefit of the Members of the committee who might have a little problem, didn't pass those tests to get in the Air Force years ago, because of the colors, I would appreciate it if you could better explain what is in the chart. I am having a problem. Maybe no one else is.

Mr. Selby. All right.

Chairman ST GERMAIN. The yellow consists of 4-family.

Mr. Selby. 1 to 4 family.

Chairman ST GERMAIN. Would you just walk us through the color chart here.

Mr. Selby. Right. As you see, in 1981, the portfolio was primarily in 1 to 4 family mortgages and some land development loans. At the time of the receivership, most of it was—the blue was the residential-commercial-condo lending development.

Chairman St GERMAIN. Other than 1 to 4 family?

Mr. Selby. Office buildings. Anything above 1 to 4 family. And the green was pure land development loans, purchase of land, holding of land for future development.

Chairman ST GERMAIN. The yellow seems to be about equal in 1981, at the time of the receivership. Am I seeing that properly?

Mr. Selby. That is correct. The 1 to 4 family traditional mort-gage lending remained approximately the same.

Chairman St GERMAIN. It was a constant?

Mr. Selby. Yes.

Chairman ST GERMAIN. Thank you. All right.

Mr. Selby. At the same time as you had the growth, you had a reported net worth that increased steadily. I might hasten to say, net worth increases easily when you are generating profits up front of the lending and not collecting those profits at the end of the lending. I call it "phony profits" or "self-generated profits" during

the period of time.

The supervisory history was that basically after the acquisition, we quickly saw, through the examination process, unsafe and unsound practices, violations of regulations. Early in 1984, we did place a cease and desist on the institution. We continued to examine and continued to see deterioration in the assets and recommended several things that culminated finally in early 1984 or 1986 in asking the board of directors of the institution to sign a consent merger agreement with the Federal Home Loan Bank of Dallas for FSLIC.

The board of directors refused to sign the consent merger, which basically gave FSLIC the right to try to sell the institution or try to resolve its problems through recapitalization or sale. The Board refused to sign it. We again went—we were in the process of examining. We tried again in early September. They again refused to sign the consent merger. The total insolvency was so clear that then we

placed it into receivership with FSLIC at the end of September 1986.

The end result of this lesson, I guess, is, first of all, from those very same profits that were generated during the couple of years that the institution was financing up front these and interest fees.

The total known compensation to date, although it is not a real sure figure, but this is as best as we've gotten so far, compensation in dividends paying to the debt owner during that period was in excess of \$3 million. The results of the strategy of rapid growth and investment in high risk assets, where you have the accumulation of bad assets in the portfolio representing approximately 50 percent of the loan portfolio are in delinquent, repossessed or foreclosed loans.

Loan losses to date in the institution are \$350 million. Probably will be more, the costs translating directly to FSLIC and to the insurance fund for this association.

I might say that we were sued on this case, questioning our authority to place it into receivership due to insolvency, and the District Court, a couple of weeks ago, ruled that FSLIC and the Federal Home Loan Bank Board, indeed, had the authority under the statute, to put it into receivership because of the dissipation of assets, as a result of unsafe and unsound practices and violations of the law.

The second case is similar. It was also acquired in 1982 by an investor-realtor, also a rural S&L that moved to a metropolitan area. Its growth was similar. 1627 percent annualized growth over the period. An association started out at \$78 million, that increased to \$1.3 billion in that 3-year period. Again, growth funded by volatile and high-cost liabilities. 30 percent of the liabilities were in broker deposits. The rest were in jumbo CDs.

Again, the asset shift was from the low risk, family mortgage lending to ADC lending. Again, the yellow, as you can see in this case, Mr. Chairman, the institution was primarily a home lender in 1982 on 1 to 4 family, with the yellow predominant, moving to the end of 1986, the majority was in the residential-commercial lending, and a substantial amount in the green was in land holding and development, and as you see, the traditional mortgage portfolio had

shrunk considerably to a much lesser amount.

This institution also had an innovative way, I guess to generate income. They financed all closing costs and fees up front. They financed almost the whole purchase price of land. And land, basically, was sold three or four times in a 6-month period with prices going up, and they also generally financed the future interest costs on the loan from anywhere from 3 to 5 years, all of those costs being carried on the books of the association up front and the income, obviously, being generated for the association up front during the early years.

The net worth, as a result of that, showed an increase up until the time that losses were discovered. Again, in this supervisory history, the association was not subject to any concerns at the time of acquisition, but then post-acquisition examinations resulted in our finding significant violations of regulations, basically, unsafe and unsound practices. Lending deficiencies, again, poor underwriting standards that led to the accumulation of assets and losses. And we have gone all the way in our process from supervisory agreements from a cease and desist to a consent merger agreement that was executed by the Board late in 1986.

The association also executed supervisory agreement with Mr. Bowman's department in 1986, and there has been a State agent in

the association since that time.

Chairman ST GERMAIN. Am I reading this correctly? What was the highest net worth for Association B?

Mr. Selby. Net worth got up to, what, \$60 million, \$70 million.

Chairman St Germain. And that was in 198——

Mr. Selby. That was the end of 1985.

Chairman St Germain. And on December 31, 1986?

Mr. Selby. In 1986, the association reported, at the end of 1986, a negative net worth of \$350 million.

Chairman ST GERMAIN. It went from a positive of a little under

80 to a negative of 350?

Mr. Selby. That is correct. As a result of, basically, \$60 million or \$70 million in operating losses for the year of 1986 and the requirement to reserve against loan losses of something like \$340 million in that same period.

That was part of the result on the next. In this one, we have found that total known compensation and dividends paid to the shareholder during this period exceeded \$8 million. The association also used, freely, a lot of nonearning assets of the association, luxury automobiles, a hunting club, a yacht, five airplanes and pilots, three beach houses, through this association.

As you can see, the accumulation of bad assets that led to the losses, some \$900 million, representing 67 percent of the total portfolio being delinquent 60 days or more, foreclosed or repossessed.

and the losses up to now of \$300 million, as I described.

The third association is one that is similar. Acquired also in 1982 by a single investor. Also formulated a growth strategy; however, in this case, the growth was not a phenomenal upswing as in the other two. This was a steady growth. It was a controlled growth, and it was a managed growth. Basically, this institution went from \$80 million to \$225 million in that period of time. Again, the asset strategy changed, but not as dramatically as the other. As you can see, the traditional mortgages, the yellow, the 1 to 4 family lending, remained approximately the same. A large portfolio on that, and then the investments in ADC lending and land loans also increased.

The net worth grew steadily but declined at the end of 1986, due to operating losses the association sustained because of their level of nonperforming assets in the portfolio, which was only 27 percent

compared to the 60 and 70 percent in the other instances.

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It is interesting in this case that the association had an independent review of their portfolio done by a consultant who issued a report which showed that the collateral of the loans secured by collateral in this institution were far superior to most that they had seen in the State of Texas, and indeed, that the values supporting this loan portfolio were more likely to recover than any of the other two cases that I described.

I'd also say that in our examination of this institution, we did use the asset classification. We did end up with a heavily classified

association because of the condition of the portfolio.

But because of the value of the collateral as we saw in the future and the ability of management and the control policies that they utilized, we have not at the Dallas Bank required substantive writedowns on those assets, even under the asset classification system.

If that is a form of forbearance, that is what we are doing in this institution. We are forbearing because of our confidence in man-

agement.

Contrary to the other two associations, they have not subjected large withdrawals in the form of compensation or dividends from the association. As a matter of fact, management voluntarily ceased dividends at the end of 1985, when they assessed their own portfolio and decided that they had problems that did not justify the continuance of dividends.

We have had successful meetings with the management and ownership of this institution. They have conformed to our supervisory agreement and are working hard to come out of their economic problems. We feel very comfortable with their management; we think their situation is controllable. And I think it is appropriate in this instance that we, as Federal regulators on behalf of FSLIC, help this institution return to viability over the period. And we think we can.

These cases, the three cases, are not unique. We have more of them in District 9. Fortunately, Association A and B are in a minority. But, as you might suspect, and appropriately so, they take up most of our supervisory time and action in dealing with associations like that.

We think these cases are illustrative of our approach out of the Dallas Bank to work cooperatively with the good management, individually, give forbearance to associations where it is appropriate and where they deserve it. But also address firmly the problems of imprudent and unsafe management of associations.

Mr. Green. Mr. Chairman, much has been done by the Federal Home Loan Bank of Dallas to ensure that well-managed institutions suffering from economic problems are given every opportunity to recover and prosper. Substantial, practical forbearances have

already been provided.

For example, fully 44 percent of the institutions in the 9th District are operating with regulatory capital below minimum requirements. Actions to address the industry's financial concerns have also been taken by the Federal Home Loan Bank Board in Washington.

Announcements were made recently about changes in asset classification, appraisals and troubled debt restructuring, as well as a formal forbearance policy for well-managed institutions that have

been affected by economic problems.

With respect to recently-introduced legislation to provide forbearances to institutions located in economically depressed areas, we fully endorse those measures that provide for flexibility in dealing with the institutions located in such areas.

Indeed, where discretion is already provided for in the current regulation, the Federal Home Loan Bank of Dallas has exercised.

We also endorse many of the concepts, including the use of GAAP accounting and FASB 15 embodied in the proposed bill. We favor the Bank Board undertaking a study of the creation of an asset acquisition corporation to warehouse real estate assets, and actions increasing the autonomy of the FSLIC.

We also applaud Congressman Bartlett's recognition of the need for limits to be placed on commercial lending, collateral requirements on development loans, particularly the requirement that the

borrower have equity in the project.

We do not endorse the proposed amortization of loan losses over a 5 to 10-year period, principally because this approach is inconsistent with GAAP and we personally feel that this move to GAAP is very important for this industry as soon as is humanly possible.

There's no doubt that the challenges we face today are serious, both for the industry and for the public it serves. Yet, the thrift industry has earned and deserved the support of the American

people over the years.

We believe that the Federal Home Loan Bank System also has earned that trust and support. The strongest step that can be taken to address the problems at hand is the administration's plan to recapitalize the FSLIC.

That plan is but one example of self-help programs that the thrift industry and the Federal Home Loan Bank System are pur-

suing, and others are contained in my written statement.

The Federal Home Loan Bank of Dallas itself provides substantial support to the industry, using the resources of the bank, which

are of course the resources of the industry.

As an example, the Dallas Bank has been advancing funds to financially troubled institutions as its lendor of last resort. In some situations, loans have been guaranteed by the FSLIC and, in emergency situations, our loans have not been as fully secured as in our normal credit practices.

In taking some of these special actions, we have made decisions in our credit and banking capacities that are in the public's interest and, at the same time, increase the risk exposure of our organization. Yet, again, this is another way that the Federal Home Loan Bank System is able to help the industry help itself.

Recently, the Dallas Bank held a series of six meetings to which all Texas savings institutions were invited. During these meetings, we distributed an annonymous questionnaire. Some of those results

should be interesting to this committee.

When we asked these institutions' overall view of the Federal Home Loan Bank of Dallas recently regulatory efforts, 70 percent said they believe that their views and opinions received fair consideration by the bank, and 74 percent indicated that they thought the bank's regulatory approach was appropriate.

In addition, 64 percent believe that the press inaccurately reports an industrywide viewpoint of overkill when, in fact, that is

not the case.

Moreover, when asked for their single preference for a regulatory approach to the hopelessly insolvent thrifts, 76 percent said that they would favor a permanent solution such as a financially-assisted sale or merger or a liquidation.

Sixteen percent preferred a program of granting forbearances, and 8 percent felt that a holding pattern approach, such as the MCP Program, was the desired solution.

Support for a recapitalization measure was overwhelming with 91 percent of our respondents favoring the need for one of the two

self-help programs proposed.

We are particularly pleased to bring these items to your attention in this forum. The Federal Home Loan Bank of Dallas features both banking and regulatory functions. One of our greatest strengths is that both of these functions are centered in one system. As a result, an integrated approach to resolving industry concerns and problems can be pursued quickly and efficiently.

The Federal Home Loan Bank System is truly a system that provides self-help to the thrift industry. The single most important action that Congress of the United States can take at this time is to pass the administration recapitalization bill. The depositors in America's federally-insured savings institutions deserve rapid consideration of this measure, so that the Nation's thrift industry as a whole will be able to continue to remain strong and meet its congressionally-mandated requirements for providing affordable home ownership and other community services.

Thank you, Mr. Chairman.

Chairman St Germain. Mr. Green, who'd you say took that poll? Mr. Green. We did, Mr. Chairman. We had a series of six meetings.

Chairman ST GERMAIN. Did you employ somebody to take the

poll, or did you do it?

Mr. Green. No, we did it. We did it ourselves.

Chairman ST GERMAIN. Do you feel that you're competent pollsters?

Mr. Green. Yes, sir, we do.

Chairman St GERMAIN. Wow. [Laughter.] Mr. GREEN. We have many talents there, sir.

Chairman ST GERMAIN. Well, I think that's reaching a little far. Seriously. I'm very serious. I'm appalled that you come up with a

poll that you, yourself, take about yourself.

As a matter of fact, you should be very concerned. Thirty percent—if you got 70 percent that think their views and opinions received fair consideration and so forth, that means that 30 percent think the opposite.

Aren't you concerned?

Mr. Green. Well, Mr. Chairman, we-

Chairman ST GERMAIN. They were gutsy people to tell you that. We're not questioning yet. I just thought I'd make that observation.

Mr. McAllister, you are here on behalf of and as President of the Texas Savings and Loan League, and as Chairman of the Forbearance Committee of the United States League of Savings Institutions.

We'll put your entire statement in the record. You may proceed.

STATEMENT OF W. W. MCALLISTER, III, PRESIDENT, TEXAS SAVINGS AND LOAN LEAGUE; AND THE U.S. LEAGUE OF SAVINGS INSTITUTIONS

Mr. McAllister. Mr. Chairman, Members of the Committee, my name's Walter McAllister, III. I'm Chief Executive Officer of San Antonio Savings Association, a \$2.7 billion institution headquartered in San Antonio, TX.

As has been said, I am here today in my capacity as President of the Texas Savings and Loan League, and also representing the U.S.

League of Savings Associations.

In my written statement, I've shown how depression conditions in some areas of the country are approaching levels we haven't seen since the 1930s. A direct fallout of these conditions is that the whole financial infrastructure in those areas is being seriously threatened.

In this economic environment, the problems of savings institutions are being compounded by the unrealistic and harsh asset writedown policies adopted by the Federal Home Loan Bank Board.

The system of accounting for assets in troubled areas has been termed liquidation, or "fire-sale" accounting. Our call for a change in attitude is not just motivated by our desire to try to give well-managed institutions time to work out of their problems; it is also, we believe, in the best interests of the FSLIC.

For this reason, our forbearance program is supported not only by those in States with economic difficulties, but also by those in the industry located in areas of the country which, in general, do not need such forbearance. They see it as a way of lessening the demands on the FSLIC.

Members of the committee from the Northeast will remember that many of their constituent savings institutions were in serious trouble in 1981 and 1982. Because of a stretchout approach—such as the use of the Net Worth Certificate Program at the time—not only have these institutions returned to robust health, but also the FSLIC saved billions of dollars in the process.

These savings for the FSLIC have been documented by the GAO. Indeed, if there's not a change in the Bank Board's current attitude toward asset writedowns, no amount of money will solve the

FSLIC's problems.

How can we solve these problems if we assume that all of these properties have to be disposed of in almost nonenxistent markets?

Undoubtedly, there are institutions in States in question that are dead or dying of self-inflicted wounds, and need to be disposed of.

On the other hand, however, there are also a great many institutions now experiencing financial problems in these distressed States that are guilty of nothing more than failure to predict the inherently unpredictable.

They have the managerial resources, if they're given the time to use them effectively, to work their way out of their current problems and greatly reduce the problem caseload and resolution costs

of the FSLIC.

The whole thrust of our forbearance concept is that the FSLIC should embark upon a policy that consciously recognizes its own

self-interest in this regard, and focus its supervisory energies on

truly serious cases.

The Bank Board should accommodate the need of well-run organizations for regulatory patience and support in dealing with

severe but transitional problems.

I'm confident that the human talent within our examination and supervisory apparatus is such that the job can be done. Certainly, the job performed by Federal and State regulators in Texas in dealing with the effects of deregulation speaks very highly of those officials' competence and determination.

Quite frankly, in the fall of 1985, I was extremely upset about a number of things going on in the thrift industry within the Dallas

Federal Home Loan Bank District.

I'm happy to report that since the gentlemen on my left, Roy Green and Joe Selby, have come on board, they have created a supervisory capability greater than has ever existed in the Federal Home Loan Bank System.

For the past year and a half, they've removed a large number of

savings and loan managers, as they've demonstrated.

In my opinion, this cleanup process is now approximately 90-95 percent complete. However, I do believe there are fundamental problems with utilizing the existing regulatory accounting format in dealing with the current economic downturns.

Its emphasis on appraised values rather than generally accepted accounting principles in establishing loss reserves serves only to ex-

acerbate existing problems.

This emphasis forces lenders to evaluate their portfolios as though all properties securing troubled loans would be instantly

liquidated in the present depressed real estate market.

In the real world, it is unlikely that this kind of mass disposition would actually take place, especially in currently depressed markets such as Houston, since such dispositions frequently prove literally impossible due to the concentration of distressed properties in the same market segment.

Additionally, we are concerned that even if such mass sales were possible by institutions, many of which have heavy problem asset concentrations, they run the risk of sparking a self-fulfilling round of further writedowns in which all lenders would participate because of an inability of the market to absorb all the properties being auctioned off by the lenders.

Another reason to avoid such dispositions is that the holding costs in insured depository institutions are less than for developers

or other private workout firms.

The accounting problems of our institutions in distressed areas come from an over-reliance on appraisals. This puts us in the ludicrous position that we're almost unfortunate that most of our loans are secured by real property rather than being unsecured.

Appraisals are an underwriting rather than accounting technique. The over-reliance on the appraisal model to establish book values recognizes future gains and loss in the current period finan-

cial statements.

This is a complete contradiction of the principles of GAAP accounting, which recognizes gains or losses in the period in which they're incurred.

I might add that GAAP accounting is used by all other business and financial institutions in the USA.

In my written statement, I've explained in detail the types of problems we have in the accounting area. They're very complicated topics. And if we have time in the question and answer period, I'll be happy to field questions on these issues.

In conclusion, we welcome the statement on forbearance that Bank Board Chairman Gray issued last week, but we do believe that it has several deficiencies. Indeed, it is obvious though that the progress we have made to date in advancing the forbearance concept reflects in part the increased awareness of a growing number of Members of Congress, that the funding legislation for the FSLIC should not be enacted until the Board adopts an acceptable program for dealing with the problems of institutions in depressed economic areas.

This approach will minimize FSLIC outlays. In general, we would prefer that the problems in this area be dealt with at the regula-

tory rather than at the statutory level.

However, if the regulator is not willing to adopt appropriate policies and measures, then we believe it's necessary for the Congress to step in and force the necessary changes.

In summary, I strongly believe the program to buy time for well-managed institutions with asset holdings in economic depressed areas goes hand in hand with any funding program for the FSLIC.

Congress should not pass any funding legislation until it is satisfied necessary forbearance and accounting reforms are not only promulgated but will be adherred to by the Bank Board.

Without that assurance, we believe the Congress should chart

the appropriate course for the Bank Board to follow.

This concludes my formal statement.

Thank you, Mr. Chairman.

[The prepared statement of Mr. McAllister can be found in the appendix.]

Chairman St GERMAIN. Thank you, Mr. McAllister.

Let me see if I understand you. You've got me a little confused. Are you calling for a statutory or a regulatory reply to the forbearance problem?

Mr. McAllister. If we can get a sufficient regulatory solution to

it, we would be in favor to that.

There is one issue which I think needs to be addressed on a statutory basis, and that's Congress Bartlett's request for a five to 10-year amortization of these losses.

The benefit to our institutions from a statutory approach would be that by having Congress address this, it might lessen the chances that auditors of these institutions would enter the phraseology about questioning the ability to be a going business.

So, in that one instance, if Congress were to address it, we think

it would be constructive for the industry.

Chairman ST GERMAIN. Mr. Green, it's my understanding that Rule 4l(B) pertaining to real estate appraisals was first promulgated in 1982.

Is that not correct?

Mr. Green. That's my recollection.

Chairman ST GERMAIN. But . . . it's also, I'm told, a fact that real estate appraisers were not made aware of the existence of Rule 41(B) until 1984.

And this just comes to me from staff discussions, representatives of that industry, you know, for whom we have a great deal of respect.

Now, as a result of the total lack of enforcement of 41(B), we now have Rules 41(C) and (D). My question is why wasn't 41(B), once

promulgated, properly enforced.

And had that been done, would we now be in a situation where we wouldn't need 41(C) and (D)? And many of the problems we now face with appraisals, that are being experienced today, would not have occurred.

Mr. Green. Well, Mr. Chairman, when R41(B) came into existence, it's my recollection that there was a lot of talk within the appraisal industry about this; a lot of concern at that time.

And as 41(C) was developed, the idea behind it, as my recollection has it, was to be more explicit in explaining what the Bank

Board had in mind with our R41(B).

Chairman St Germain. That took a long time, didn't it? 41(B) was written, adopted and—

Mr. GREEN. Yes, sir.

Chairman St GERMAIN. Espoused in 1982.

41(C) was issued a year ago. Correct?

Mr. Green. That's approximately the timing, yes, sir.

Chairman ST GERMAIN. I think it's pretty close, isn't it? What

happened in between? Where was everybody?

Mr. Green. Well, I think, during that period of time, of course, the Bank Board and appraisals—appraisal people—were exchanging information about, you know, what some of the potential changes should be made.

And I think our—-

Chairman ST GERMAIN. Mr. Green, because of the limited time we have, let's go to the last part of my question. Had 4l(B) been promulgated, been insisted upon, would it not have diminished the reason and the need for 4l(C) and (D)?

Is that—I mean, is that an improper sequitur?

Mr. Green. I think that I could say that had 41(B) been used-

Chairman ST GERMAIN. And adherred to.

Mr. Green. And adhered to in the industry in the underwriting process, we probably would not have some of the problems that we're facing today.

Chairman ST GERMAIN. You wouldn't see examples like (A) and

(B), would you?

Mr. Green. That's correct, sir.

Chairman ST GERMAIN. They would not have come into being.

Mr. Green, what was the environment 2 years ago in the industry in the area within jurisdiction of your regional office that prompted action by you and the Federal Home Loan Bank Board that resulted in management consignment program institutions?

Mr. Green. Mr. Chairman, some 2 years ago, the industry in Texas, and predominantly in our District, had grown the 3 years

previously at an average annual rate of 35 percent.

If you look at the MCP programs, which the institutions that are now in the MCP programs, those institutions were growing in that same period by an annualized rate of between 99 and 100 percent

per vear.

These institutions were growing at this phenomenal rate by paying from 100 to 125 basis points above what commercial banks were paying, some 50-75 basis points above what some of the more conservative savings and loans were paying, and about 50 basis points above what nationwide depositors were getting in the savings and loan industry.

During that same period of time, banks across the Nation were only growing at a 7.7 percent annual rate. And in Texas, at an 11.4

percent.

So what we had, Mr. Chairman, was this huge inflow of money that was basically looking for a home in investments, primarily, of course, in Texas, too. And they were competing with commercial banks who were paying 100 to 125, in some cases, 150 basis points

less for money for the same investments.

And so it doesn't take any brilliant individual, I think, to conclude that many of the better loans went to the institutions that could loan that money out for less money, because it was costing them less, and many of the more marginal loans—the ones that would attract high fees—would be housed within the savings and loan industry.

So there was an explosion of this risky asset base that Mr. Selby mentioned in a situation that just had to be contained or the

system was going to self-destruct, in our estimation.

Chairman St Germain. My time is expired.

Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman. I have a question for you,

Mr. Green, and I'd like a response from Mr. Selby also.

You state on page 3 that problems in the 9th Federal Home Loan Bank District are primarily the result of deregulation and the economic downturn. And you go on to point to actions in 1980 and 1982 as examples of deregulation. And I presume you're referring to the Monetary Control Act the Garn-St Germain Act, both actions taken by the Federal Government.

Is that right?

Mr. Green. Yes, sir.
Mr. Wylie. Now, we've been told that about 90 percent of the FSLIC and insured thrifts in Texas are State chartered. Now, a State charter may have been more advantageous than a Federal charter because Texas, I believe, as early as 1981, took action to deregulate thrift powers far beyond those taken at the Federal level.

That's true, isn't it? Mr. Green. Sure.

Mr. Wylle. OK. Now, to what extent are the thrifts that are in trouble experiencing those difficulties because they took advantage of those broader State authorized powers?

Were those thrifts subject, in your opinion, to adequate supervision at the Federal and State level? Two questions there, but

they're related.

Mr. Green. Mr. Wylie, let me say that, first, as I think you probably know, I was extremely supportive of the deregulation of the thrift industry, supportive of the Garn-St Germain legislation that

brought those additional powers in.

However, we, in a sense, had a problem where this industry that was locked in at that particular time to basically a single-family portfolio for the most part found itself with assets that were not yielding sufficient to even pay the cost of money at that particular time.

And so there was this tremendous rush to grow out of their problem. And so a portion of this, unquestionably, was because some individuals within the industry reached too far and tried to grow too

fast and could not keep up with that growth.

And so part of it was because of an over-reaching. Part of it was because of a serious downturn that we had in the economy in our area over the last 18 months, which has phenomenally impacted values of real estate, even for those people who underwrote their loans very, very carefully and had a reasonable downpayment. Those, in addition, are being hurt.

Mr. Wylle. I'm going to ask Mr. Selby to respond, but, ancillary to that, if the Bank Board's direct investment regulation had been in effect, would that have helped? Or would the institutions still be

in trouble?

Mr. Selby. Well, I think the direct investment regulation would have helped. It would have curtailed some of the problems we have. But a lot of the problems are there because of not the direct investment regulation, but just making poor managerial decisions under poor underwriting.

On the question of—and the statement clearly shows that the

economy is part of it, but there were other segments.

Mr. WYLIE. How about deregulation of thrift powers? Would you

like to comment on that?

Mr. Selby. The deregulation. Well, I think the statement says that, in the environment of deregulation, that the economy had a

profound effect upon the institutions.

What I was going to say along with the deregulation which everyone supported, including the banking agencies and the thrift industry, I think, in my perspective of just coming with the thrift industry and the question of our abilities, I think the Federal Home Loan Bank Board has responded rather quickly to some things that needed to be done probably earlier from the standpoint of supervision, regulations, of looking at these new powers and how they can be supervised or regulated by the Federal Home Loan Bank Board.

I think if we had had the asset classification regulation back in 1982, 1983 and we had adequate staff of examiners trained in the supervision of a deregulated environment, I think perhaps there might have been a better ability of the supervisors-regulators to

criticize and help prevent some of the problems.

I think we're in the process of that right.

Mr. Wylle. One last question. I have about 30 seconds left. Where were the Federal and State regulators, and I ask this, do you think there was adequate supervision, but where were they when these institutions were growing by 1,400 and 1,500 percent over a two or three year period?

Mr. Green. Well, Mr. Wylie, let me say that during that period of time, the examiners were from the Bank Board itself. They were

government employees. And because of OMB constraints, salary constraints, we were not able to attract the numbers of examiners and the expertise that we really needed as a system to cope with a

deregulated environment.

Since July of 1985, when the Federal Home Loan Bank Board transferred the examiners to the individual district banks, we have upgraded this force tremendously. We have significantly more than doubled that force. We have hired people from the Federal Reserve System, from the Comptroller of Currency's force, from the FDIC, and we have some tremendous expertise now on board because we're able to pay competitive salaries.

We're able to hire the number of people that we think are

needed to get the job done.

Mr. Wylle. My time has expired. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Almost sounds as if there was a competition in laxity.

Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman. Mr. Chairman, first of all, let me welcome the members of this panel this morning. I think that you brought some very important and interesting testimony for the consideration of this very, very important problem.

Mr. Chairman, repeatedly this morning, we hear the word "appraisals" coming up—whether they're going to relax appraisals or whether or not they're going to enforce appraisals, whether it's

going to be 41(B) or 41(C).

And I think that that's a subject that we could spend the whole time on this morning. For the members of the committee, I'd like to refer you to a study that we did in the Government Operations Committee, entitled The Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance and Investment in the Secondary Market.

But, in this particular study that our committee did, we found out that there's no regulatory process as far as appraisal is con-

cerned.

Mr. Bowman, who licenses appraisers in Texas?

Mr. Bowman. Mr. Barnard, I don't believe there is a licensing agency.

Mr. BARNARD. Is there a licensing agency in any State in the

Union?

Mr. Bowman. Not that I'm aware of, no, sir.

Mr. BARNARD. So how do you measure the caliber of an appraiser? I mean, what goes into you as a State savings and loan regulator, what reliance do you have on the appraisal that's in the file?

Mr. Bowman. The best we have been able to determine, it's based on experience. If we have good experience with an appraisal firm and their values hold up to the test of time and sales, then we traditionally will use that firm.

We don't recommend them because that's not our position. But

we will use them in reviewing the work of other appraisers.

You recall from your subcommittee's work on Empire Savings the appraisal issue became very, very paramount at that time. And since then, we have tried, without licensing as such, we have tried to determine the expertise, the value of certain appraisal firms in the State which we will use.

Mr. BARNARD. Mr. Green, wasn't that one of the reasons that 41(B) was put in place to begin with? Was because there was no adequate regulation having to do with appraisals?

Mr. Green. That is very correct, sir.

Mr. BARNARD. And what you did in 4l(B), which you didn't utilize, which the chairman has brought out possibly, was the fact that you wanted more than just a statement as to the value of the land or the property, that you wanted something to back it up on.

Mr. Green. We wanted a professional job done evaluating the

property, that's correct, sir.

Mr. BARNARD. Now, have we clarified now that this was put in 1982 and not enforced until 1984-1985? I mean, what is the story on that? I'm confused.

Mr. Green. I do not recall the specific dates. But, you know, it seems like that that's approximately the time.

Chairman St GERMAIN. Mr. Barnard, would you yield?

Mr. Barnard. Yes.

Chairman St Germain. I mean, golly gee, we've got very competent Federal Home Loan Bank Board people here. You're telling me that you can't come up with that date? It's infamous in history. I mean, it's going to go down with the Battle of Hastings. [Laughter.]

Mr. Green. My apology, Mr. Chairman, I do not have that. I'll

certainly get it for this-

Chairman St Germain. It was 1986, sometime, wasn't it? C&D. When was (C) promulgated?

Mr. Selby. (C) was in 1986.

Chairman St Germain. Yes. And (B) was in 1982.

Mr. Selby. That's right.

Mr. BARNARD. Now, I don't want to take up all my time on this particular subject, but it's something maybe we'll have to rehash as we go further into hearing this morning.

Mr. Green and Mr. Selby, when did you all go on board in Texas?

Mr. Green. I went there in September of 1984, sir.

Mr. Barnard. And-

Mr. Selby. May the 1st, 1986.

Mr. BARNARD. OK. I notice in these illustrations this morning that most of the problems began right after 1982. OK. Two questions.

Do you all require an independent audit of savings and loans?

Mr. Selby. Yes, sir, we do. Mr. Barnard. You do? Well, what did these independent audits say about these institutions that were these high flyers? Did they indicate—was there a red flag there from their audits that these people needed to be looked at?

Mr. Selby. I believe the audit reports were clean reports issued on the associations without any flagging of asset quality or under-

writing deficiencies.

Mr. BARNARD. But, did they classify the assets?

Mr. Selby. No, no.

Mr. Barnard. Now, this brings me back to this question. How many times did the Federal Home Loan Bank Board or the District Federal Home Loan Bank Board examine these institutions when you noted that they were really going sky-high?

I mean, did you pay any particular attention to them? Or did you just conduct the normal annual or 18-month audit . . . or examination?

Mr. Green. Here, again, we're talking about this period of time, 1982, 1983 and 1984, when there was this phenomenal growth, when there was some huge problems that had developed, such as Empire; although that I was not there for the majority of that time, I think that, you know, as truthful matter, we were addressing the forest fires that were going on out there.

Mr. Barnard. But, could I say then, and I'm not demeaning the Bank Board, I'm just trying to get to the core of it, if we had had the same regulatory force, the same supervisory, the caliber and quality of the supervisory forces between 1982 and 1984, would these kind of cases have created the problems that we have today?

Mr. Green. These would be the isolated cases, in my estimation. But let me say that, some of them, when they go in there with the idea that we're going to really abuse this institution, they can do it in such a short time with the use of high cost money, that it is very difficult.

But, with our force that we have right now, we can follow up on that in a much more efficient and prompt manner.

Mr. Barnard. Mr. Bowman.

Mr. Bowman. Yes, sir.

Mr. BARNARD. What did you do in the same instance? How long have you been the regulator?

Mr. Bowman. I was Deputy Commissioner from 1980 until 1983 and I've been Commissioner since January of 1983.

Mr. BARNARD. What would you have done? Did you have these same situations with State chartered institutions?

Mr. Bowman. Yes, sir.

Mr. BARNARD. And what would you do in those indications?

Mr. Bowman. We increased our examination of both examples A and B. And as Mr. Selby pointed out, we had (B) under State control or supervision at the time the FSLIC took it over.

The biggest problem that we have run into is an inability on the part of the regulators themselves, both State and Federal, to have been deregulated in the same manner that the industry was deregulated.

We had our hands essentially tied, not through necessarily due process, but through the definition of problems that we had with

unsafe and unsound practices, this sort of thing.

I would have to respond that if the same people had been at the Dallas Bank in 1982 and 1983 that are there today, the situation would have been much less serious than it is today.

Mr. Barnard. So we are really having to go through the process of forbearance today because we didn't have adequate supervision by the Home Loan Bank Board? I mean, you all are new. We're not trying to blame anybody. But, some of the problems that we've got today are because of inadequate supervision in regulation?

Mr. Green. Saying it that way, yes, sir, some of it is. Some of it is because of in a zealous attempt to increase net worth of the institutions, basically, we let a lot of individuals into our industry in

1980 to 1982 time frame that proved to abuse the charters.

Mr. Barnard. Didn't you carry forth the law which we've passed as to the change of management in these institutions? Did you look at the new management?

Mr. Green. We are doing that diligently at this time. Mr. Barnard. But you didn't do it, not in 1982 and 1984?

Mr. Green. I'm sorry to say I was not there at that particular time, but history has shown that we apparently made some mistakes.

Mr. BARNARD. I might not get another crack at you fellows. Let

me ask another question.

Chairman St Germain. Absolutely. We're going to stick around. Mr. BARNARD. How much of this growth came from direct investments as opposed to poor loans?

Chairman ST GERMAIN. Which growth?

Mr. Barnard. The growth of ABC.

Chairman St Germain. Do you want them separately? Mr. Barnard. Yes, that would be fine. I notice in your charts, it looks like to me that the assets that you've determined were all assets within the bank and not direct investments through the holding company.

Mr. Selby. My guess, without giving you—we certainly can get back to you and give you the figures, Mr. Barnard—my guess, that

a substantial portion of it was direct investment.

Mr. BARNARD. Well, let me say this. I want to compliment the Home Loan Bank Board last Friday. It has finally come to that consensus and they are now looking at the correct regulation and supervision through their own forces of direct investments and not having to bother the Congress with it, Mr. Chairman.

I do want to comment that I feel like they have taken a small

step forward.

Thank you.

Chairman ST GERMAIN. Mr. Bowman.

Mr. Bowman. Yes, sir.

Chairman St Germain. You stated—and I think in answer to a question of Mr. Barnard's—that had we had the same type of supervision, regulation and examination from 1982 to 1984 that we have had since the change in regime in 1984 with the advent of Mr. Green that things would have changed dramatically, is that correct?

Mr. Bowman. Yes, sir, I believe that is true.

Chairman St Germain. And the problems would not be as great as they are today?

Mr. Bowman. That is correct.

Chairman ST GERMAIN. Is that not the period of time during which the Home Loan Bank Board and FSLIC reduced their forces as far as examiners, and so forth, are concerned? Well, let me ask Mr. Green that.

Is that not the case? Have you not increased dramatically the number of personnel in your regional office?

Mr. Green. We have increased dramatically.

Chairman St Germain. It had been decreased under your predecessors, correct?

Mr. Green. Mr. Chairman, the level of examiners and supervisory personnel across the Nation had not been reduced. At the Federal Home Loan Bank of then Little Rock, when they moved from Little Rock to Dallas, a number of the supervisory people chose not to make that move, and so involuntarily there was a decrease in numbers of people, but the Bank immediately tried to get back up to staff.

But we have made phenomenal increases in numbers of both supervisory personnel and examination personnel since that time.

Chairman St Germain. I am going to have my staff prepare some questions, very specific questions here. I want to make sure that we didn't neglect—by "we," meaning the Home Loan Bank Board—that particular regional office in Dallas.

Mr. Barnard. Mr. Chairman? Chairman St Germain. Yes.

Mr. Barnard. If I might. Would you yield just for——

Chairman ST GERMAIN. Sure.

Mr. Barnard. What happened was, see, the Federal savings and loans were examined by the Home Loan Bank Board of Washington, DC., and that is when they had the staff reductions and that is when the Home Loan Bank Board had to strengthen the examination force by transferring that to the district Home Loan Bank Boards.

But they changed the whole examination structure in that period of time.

Am I wrong there?

Mr. Green. That is correct, sir.

Chairman ST GERMAIN. Let me ask this. Mr. Selby, you were, I think, in the Comptroller's Office how many years?

Mr. Selby. 31 years.

Chairman St ĞERMAIN. 31 years.

OK, you remember Jim Smith's appearance before us after Franklin National?

Mr. Selby. I do.

Chairman St Germain. Yes, sir.

OK, and he came up and he told us that he had commissioned these people and they were coming up with these great computers, and then every time there was another problem at the Comptroller's we were getting new early warning systems from the computers.

Mr. Selby. Right.

Chairman ST GERMAIN. Does the Home Loan Bank Board have an early warning system on computers as does the Comptroller's Office?

Mr. Selby. I would say that the Home Loan Bank Board is trying to take the information that they accumulate through quarterly and monthly reports as well as examinations—

Chairman ST GERMAIN. The answer is "no"?

Mr. Selby. The answer is they are in the process of doing it.

Chairman ST GERMAIN. My question is does it have an early warning system in place?

Mr. Selby. Not operable.

Chairman ST GERMAIN. Well, if it is not operable, they don't have one.

And they didn't have one in 1982, 1983, and 1984, is that correct? Mr. Green. Now, Mr. Chairman, let me——

Chairman St Germain. OK.

Mr. Green. Let me say that we do have within the data processing system certain programs that the Bank Board has been using over the years that do have bells and whistles that they call an early warning system.

Chairman ST GERMAIN. But did the bells and whistles ring on A,

B, and C?

Mr. Green. Yes, sir.

Chairman ST GERMAIN. Will you send us the evidence to that effect?

Mr. Green. We will give you some information, yes, sir. Chairman St Germain. You are sure of that now, Mr. Green? Because if the bells and whistles were ringing, then you can't say that you didn't have enough examiners. The bells and whistles rang. You should have done something.

Mr. Green. Mr. Chairman, let me, though, pass on to you that at that particular time we did not have some of the regulatory power that we needed in the area of growth. Many of these institutions were growing basically phenomenally, and we had no way to stop that. We did not-

Chairman St GERMAIN. Sorry, I don't have any more time. You are not really addressing the question or answering my question.

We will come back to you on the next round.

Mr. Green. All right, sir.

Chairman St Germain. And we will have a little exchange.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Chairman and Members, listening to the testimony today, it seems that the industry, the S&L industry in Texas was on a 5-year joy ride and included in the car were the regulators, and all of a sudden in 1986 not only did the S&Ls run out of gas but also the economy, and now we are sitting here today.

And, Mr. Green or Mr. Bowman, correct me if I am wrong, but my interpretation of the whole forbearance question is one of a spe-

cial bailout for Texas and the S&L industry.

Mr. Bowman. May I respond to that, Mr. Kleczka?

Mr. Kleczka. Sure.

Mr. Bowman. It is incorrect.

Mr. Kleczka. What other region of the country has problems as severe as Texas or other State in the union has problems as severe?

Mr. Bowman. I believe there are other States that have come through the same economic problems in the last 5 years that Texas is suffering today.

But the problems of forbearance, the whole question of forbearance is aimed at the economy in Texas and not at the high riders who played with the savings and loans associations in the State. Those have been handled. They have been-

Mr. Kleczka. Well, some of those high riders are running the S&Ls, and there are certain benefits in the forbearance legislation introduced by Mr. Bartlett and others that would help those indi-

viduals out, also.

Mr. Bowman. I will submit to you that there are no high riders running savings and loans in Texas today, thanks to the efforts of my office and Mr. Green's office.

But I will point out one thing that needs to be said, and that is that every association owner that entered this business back in 1980, 1981, and 1982, prior to Mr. Selby and Mr. Green's entry into the Federal regulatory process on the savings and loan side, every one of those owners was approved in Washington by the Federal Home Loan Bank.

Mr. KLECZKA. OK, Mr. Green, my interpretation of the whole forbearance question is a special bailout.

Am I incorrect in that assumption?

Mr. Green. Congressman, I certainly would not classify it that way. I would not support anything that allowed people who had abused the system to be granted forbearances. I think that would

be absolutely wrong.

But by the same token, we have good operators down there who because of depressed market conditions—and on the average of going down somewhere between 16 percent and 30 percent in certain areas—who are hurt because of those depressed conditions, and I think that those deserve an opporatnity to come out of this and come back to health.

Mr. KLECZKA. OK, but going back to your Association A example, you saw the portfolio radically change over a period of 5 years to one of substantial risk.

Now, are you blaming the poor, depressed areas in Texas for that?

Mr. Green. Absolutely not.

Mr. Kleczka. Or some poor management decisions?

Mr. Green. I am blaming poor management decisions in A and B and saying that those people should not be granted forbearances.

In the case of C we are saying that this is an institution that is well-managed, that is caught in a depressed economy and should be able to help itself out.

Mr. KLECZKA. Mr. Green, do you hear talk in your district of

S&Ls shifting from FSLIC to FDIC?

Mr. Green. I think that there has been talk about that, but I have not heard anyone who is seriously considering that.

Mr. Kleczka. What is your view of exit fees as an amendment to

the FSLIC recap bill?

Mr. Green. I have no idea, Congressman, what their view might be there.

Mr. KLECZKA. No, what is your view?

Mr. Green. What is my view? Oh.

That there must be some exit fee in order for the fund to remain solvent over the years that any repayment of this indebtedness must take place.

Mr. Kleczka. Do you have any thoughts as to what that exit fee

should be?

Mr. Green. Well, there has been one mentioned by the Bank Board of—is that the 10-year approach—a 10-year approach that has been mentioned by the Bank Board, which sounds reasonable to me.

Mr. KLECZKA. Thank you very much. Thank you, Mr. Chairman. Chairman St GERMAIN. Mr. Parris.

Mr. PARRIS. Thank you, Mr. Chairman. There is such a mother lode of information here this morning it is hard to decide where to begin.

We appreciate you gentlemen bringing that to us.

A part of the definition of the magnitude of the problem facing the industry is what this is all about, and I think it is very interesting to reflect that both of these institutions that you talk about, A, B, and C, the A and B institutions, just two institutions, represent three-quarters of a billion dollars of FSLIC loss and that is 50 percent of the total reserves. That is just two institutions in one town in Texas, or maybe two towns. It is not important.

The point I am trying to make is—my understanding—is they are both State-chartered institutions, both represent the reliance

The point I am trying to make is—my understanding—is they are both State-chartered institutions, both represent the reliance on Federal insurance protection, and that is the statement of the fundamental problem here, and I think it is appropriate that this is an all-Texas panel because Texas, whether we like it or not, is in

the center of the fire storm.

Now, I would like to just review with you gentlemen very quickly the Office of Policy and Economic Research Report, Federal Home Loan Bank, dated January 30, 1987, a month ago, and it says under GAAP accounting 49 percent of the total Texas firms in the thrift industry are either insolvent or with inadequate capital. There's 137 of them, and we are just talking about two this morning just in your State alone, gentlemen.

Now, when you start to relate that to banks, you have got 4 per-

cent of the banks versus 49 percent of the thrifts.

And let's go to table 6 of the GAO report, which we have all re-

ceived, the 1986 third quarter.

In acquisition, development, and construction loans in the Texas Home Loan Bank there is 20 percent of institutions—federally insured I am talking about—20 percent with insolvent status, less than zero percent capital. Twenty percent of their total assets are invested in acquisition, development, and construction loans, 15 percent between zero and 3 percent capital, inadequate capital definition, 15 percent in that same category of loan, or a total of 35.

In response to Mr. Barnard's question, in direct investment in the Texas, the Dallas Home Loan Bank situation together, 15 percent—8 percent in less than zero percent capital, 7 percent, almost

8, in less than 3 percent.

Now, that is over 50 percent of the total assets of these insured institutions in either construction loans or direct investments in what has been categorized by both of you gentlemen, or two of you,

as nonexistent or hostile markets.

Now, I submit to you gentlemen that one of the reasons that we have already had forbearance, if you will, in those markets is because the FSLIC does not have the financial capability of doing anything but forbear. They can't take any action. They don't have any money. We have no reserves. We have no insurance. There is zero, 3.8 negative balance in the pot at the moment.

My question, I guess, to one of you gentlemen—and I would appreciate you being brief—is it realistic that the market values of inadequate security when you consider carrying costs and interest rates and some forbearance period, 5 years, 10 years, whatever, not even considering the deterioration of real estate securities—real

estate assets as security, is it possible that they will ever come back to a market situation that will not represent a huge loss to the insurance fund?

Mr. Green?

Mr. Green. Yes, I do believe that that will be the case; however, it is not going to be an immediate period of time. It is not going to be an immediate turnaround. It is going to take a few years.

Mr. Parris. Well, I understand that. Mr. Green. Yes, sir.

Mr. Parris. But when you get 50 percent of your total assets now in construction or acquisition and development loans and direct investments in a nonexistent market, how do you expect that to ap-

preciate?

Mr. Green. Well, you know, I don't want to make light of the fact that there is a serious problem there. We all acknowledge that, but I think over a reasonable period of time that these institutions will—or most of them will be able to come back to viability and a profitable operation.

Mr. Parris. My only quarrel with your statement, Mr. Green, it is not a serious problem; it is a frightening problem to some of us

and I think enormously concerning.

Let me ask Mr. McAllister a direct question, if I might.

I got the distinct impression from your comments, Mr. McAllister, that your association and you as a representative of that would support a return to GAAP as being in the best interests of the industry, your institutions, in whatever market, is that correct?

Mr. McAllister. We feel that GAAP is a more accurate way to reflect the value of depressed loan assets. We feel that it is a better reflection of what you will eventually realize in those assets and that it avoids taking losses that will occur in future years and writing them all off in this year, which is not the way other American businesses handle future losses.

Mr. Parris. And would eliminate much of the appraisal prob-

lems that we have heard about in earlier questions, correct?

Mr. McAllister. It would not completely eliminate them, but it would be a much more accurate picture of what is likely to occur.

Mr. Parris. My time has expired, but I would just say to you gentlemen, I have categorized RAAP accounting practices in this thrift industry as tantamount to government-sponsored fraud.

My time has expired, Mr. Chairman. Chairman St Germain. Mrs. Patterson.

Mrs. Patterson. Mr. Chairman, I have no questions at this time.

Chairman St GERMAIN. Mr. McMillen.

Mr. McMillen. The GAO reported last week that the Federal Savings and Loan Insurance Corporation had not properly booked its current assets. They went on to say that the Federal Home Loan Bank was stretching its losses out rather than reporting all of its losses now.

From what I understand, that procedure of stretching out losses over a longer period of time rather than booking them all at once is exactly what various savings and loans in the country, especially in Texas, have been trying to do and have been prevented by the Federal Home Loan Bank of Dallas and other Federal Home Loan Banks from doing.

Why is the procedure fine for the Federal Home Loan Bank Board to use but not fine for the thrifts to use?

Mr. Green. Congressman McMillen, I guess I am the appropriate one to respond to that, in that I think as a practical matter that because of, number one, the inability of the fund to take care of some of these massive problems that are there but, in addition to that, because of the fact that because of economically depressed conditions that we feel that there should be some forbearances, and in fact we have been giving those forbearances, as I pointed out in

my written statement.

We have not been going in and discriminately marking everybody to market. There would be, because of decreased values, some phenomenal markdowns, and so we have tried to use good judgment when we evaluated those assets, trying to determine, you know, what the eventual value of those things were, what cash inflow was coming in at that particular time, the type of management the property had, and we have tried to use judgment in the evaluation of those assets.

And so in many ways we think that has in fact been done.

Mr. McMillen. Well, aren't we in essence creating kind of a contradictory situation where at the Federal level the Home Loan Bank is stretching out its losses but we are not doing this at the local level, but in fact the end result is the same?

Mr. Green. I am sorry, would you repeat, Congressman?

Mr. McMillen. Well, if the Federal Home Loan Bank is doing this and allowed to do it and the thrifts in Texas are not allowed to do it, isn't the end result the same? I mean, aren't we eventually going back to the point where if the governing Federal regulatory

body is able to do this, isn't it contradictory in a sense?

Mr. Green. Well, Congressman McMillen, let me say that the FSLIC has not asked for any type of special accounting treatment. I think that what—the FSLIC Program is one of doing it right according to GAAP and to basically have capitalization from the district banks, which in turn would allow for the leveraging of that, to spread out that repayment over a longer period of time but strictly

GAAP accounting during that period of time.

Mr. McMillen. The next question that I have to ask refers to the Booz-Allen study that the Washington Post obtained a copy of the internal study, Federal Home Loan Bank Policies and Practices. It was published last week. The study done by Booz-Allen seems to confirm exactly what various thrifts have been saying, that the Federal Home Loan Bank policies result in artificial writedowns of assets, that its policies are not evenly applied, and that there is little due process or oversight in the system.

This was not a thrift study nor was it a GAO study; it was a

study commissioned by the Federal Home Loan Bank itself.

What are your responses to the results? Doesn't the report confirm that the Federal Home Loan Bank system has been grossly unfair?

Mr. Selby. May I respond to that? And I haven't read completely the Booz, Allen report, but we've had it analyzed. And I don't know where the analysis of the Washington Post, how it was arrived at, but as I recall, there's nothing in the Booz, Allen report that con

firms that we have, the Bank Board has been unfair or discrimina-

tory.

I read that in the Washington Post, too, and wondered how they arrived at that conclusion. The Booz-Allen study talks about the system of within FSLIC and how systems and procedures could be improved to facilitate the discharge of their responsibilities.

I don't remember reading anything that said it confirmed that we were being discriminatory or that FSLIC was being discrimina-

tory in their collection of their assets.

Mr. McMillen. I'm referring to the Washington Post, which seemed to infer that there was an almost inhouse indictment.

Mr. Selby. I guess we have to ask the Washington Post. Mr. McMillen. That would be a good followup. Thank you.

Chairman ST GERMAIN. Mr. Hubbard.

Mr. Hubbard. Thank you, Mr. Chairman. We welcome you four gentlemen to our subcommittee. On Tuesday, October 21, I was in Fort Worth, TX. I was there at the request of House Speaker, Jim Wright, to meet with constituents of his in the S&L industry and others who visited there in Fort Worth, at a meeting where these S&L officials expressed their concern and alarm at their then predicament.

Congressman John Bryant of Texas was another one present in

addition to the House Speaker and me.

Were either Mr. McAllister or Mr. Bowman present at that meeting?

Mr. McAllister. I was not present at the meeting.

Mr. Bowman. No, sir.

Mr. Hubbard. Did you hear about the meeting?

Mr. McAllister. Yes, sir. I'm very much aware of it. Tom King,

a gentleman in the audience, was present at that meeting.

Mr. Hubbard. Are you, Mr. Bowman, or you, Mr. McAllister, aware of the many charges that came from S&L officials there about discrimination, about the activities of Mr. Green and Mr. Selby, and how the S&L officials were scared to death of these two men?

Are you aware of that?

Mr. McAllister. I've heard those charges repeatedly. I don't agree with them. I think the problem is not one of personalities, I think it's one of policies and philosophies as regards these writedowns. It's not a personality problem.

Mr. Hubbard. Well, many of the S&L officials there that day were so scared of Mr. Selby and Mr. Green that they were even afraid to comment in front of Jim Wright and me.

And some waited until after the meeting to express themselves because they did not want to be quoted to Mr. Green or Mr. Selby.

One charge was made that in order to get a particular person to consent to his removal from the thrift industry of the Federal Home Loan Bank threatens the entire institution with a thorough examination, meaning a vast writedown of assets.

Another allegation that day was that supervisory agents and others get an initial perception about a person or a thrift and then, because they are so over-worked and over-whelmed, they never

spend the time to find out if they were right.

The overall point is that there does not seem to be an ability of a procedure by which someone can challenge questionable conduct by the FHLBB.

If a person or a thrift waits until a receivor or conservator is appointed, the rights to review by court, as you know, are very limited. To compound the problem, if a person wants to fight, there usually is some way for his thrift to be found technically insolvent, or to be found in need of a receivor or conservator or some other reason.

We have to legislate some due process into the system. I would like to know, gentlemen, speaking to Mr. Green or Mr. Selby, what procedures do you think would add due process without unduly restricting the agency's ability?

For example, what if Federal courts were ordered to make a de novo review of FHLBB orders and decisions rather than deferring

to the agency's administrative decisions?

And what if the Federal Tort Claims Act were amended so that suits could be brought for intentional and malicious action?

Would you address those questions, Mr. Selby, Mr. Green?

Mr. Selby. Well, I will try to follow your questions. First of all, I can't respond to the meeting that was held in Fort. Worth. I wasn't there. I've also heard of some of the comments emanating from it of the fear apparently of myself and Mr. Green, which has come out of that meeting as well as others.

First of all, it is not true that we threaten institutions or associations with examinations or writeoffs or anything else to get any of our enforcement actions done because, generally, the results of those examinations and reviews result in whatever action we feel we have to take, including a removal order, which, by the way, is not done through the Dallas Bank. It's done through the Office of Enforcement at the Federal Home Loan Bank Board.

When I came to the Dallas Bank and Mr. Green was there-

Mr. Hubbard. When was that you came to the Dallas Bank?

Mr. Selby. May the 1st of last year. I've not been there a year. We had supervision systems of reviewing reports of examination

and doing different types of reviews.

We had a system then. I've improved it a little bit. But we've always had a system of appeals that ends with the President and the principal supervisory agent. And I think he can tell you that any number of association members come to him and call to him on decisions that are made all through the process for appeal.

I did institute something we call a Regulatory Review Committee, which is made up of the senior members of Regulatory Affairs, including the PSA, to review results of examinations, proposed actions that our supervisory agents are proposing on institutions and people, which I think gives a democratic review of a process of examination supervision.

If I'm not incorrect—I'm not a lawyer, but as I recall, in a banking agency, we had all sorts of administrative hearings called by associations and members of associations and banks that objected

to our supervisory process.

And I believe, if I'm not mistaken, it's provided for in legislation to the Congress on cease and desist and other type of enforcement action.

There is a formal court procedure for appealing decisions by regulators. And I know they're used in the banking agencies.

Chairman ST GERMAIN. Mr. McCandless.

Mr. McCandless. Thank you, Mr. Chairman.

Mr. Bowman, in your opening remarks, you talked about the trouble that you're having with the appraisal system as it relates to foreclosures and establishing values during that early process of disposition of an asset.

I'm curious in Texas how this is handled within the framework of the jurisdiction responsible for collecting property tax that also must establish an appraisal for value purposes to assess that tax.

How do you—if you're going to keep the value up here at a certain level, artificial or not, but for purposes of our discussion, then do you go to the local jurisdiction and say, well, the market value of this piece of property is such and, therefore, we should only be paying property taxes on a lower figure?

Or, how does that work between the two jurisdictions?

Mr. Bowman. There's no interplay between the two, Mr. McCandless, but one of the things that has concerned me is if we go through a massive series of writedowns based on appraisal, if you will, in a marketplace where sales are not going to take place as a result of those, but merely markdowns, that you could seriously impact the ability of a school district, for example, to support itself, or the ability of a water district or a municipality to.

And my concern is that we are, as I mentioned early, if we writedown assets in this economy, based on their market value in this economy, we'll cause nothing but economic chaos. The more widespread it becomes in the State, the more widespread the chaos will become. And the inability of all of these taxing agencies to main-

tain their base.

These properties are not going to be sold in this environment and I maintain they should not be quantified in this environment.

Mr. McCandless. Do the appraisers for the municipal jurisdic-

tion agree with that philosophy?

Mr. Bowman. Frankly, I haven't seen any evidence that they want to do anything in the municipalities but increase their appraisals, Mr. McCandless.

Mr. McCandless. There seems to be some compatability there then that wouldn't result in a suit later on that I paid an artificially high tax because of the value of the property?

Mr. Bowman. We will know in Austin fairly soon because such a

suit has been filed.

Mr. McCandless. We have a very limited amount of time. I want

to move on to another area.

Mr. McAllister, there has been a great deal of discussion by the savings and loan management people about the Federal Assistance Disposition Association and that section of the bill that addresses establishing this as a statutory agency with a sunshine clause in it.

establishing this as a statutory agency with a sunshine clause in it. Would you care to comment on this? Are you in favor of this? Or, are you against it? What do you see as from the savings and loan

associations' point of view?

Mr. McAllister. I serve as the Director of the FADA. And I think, if you subjected that to the Sunshine provisions, it would greatly hinder the operation of that entity. It was designed to bring

real estate expertise to the FSLIC in the disposition of these problem assets; a number of confidential matters that really relate to individual institutions and individuals who are borrowers of the FSLIC system are discussed there. I think it would be very harmful to the FADA if that were to come about.

Mr. McCandless. So you would be opposed to this section of the bill as it's currently written?

Mr. McAllister. Yes, sir, I would.

Mr. McCandless. What kind of an amendment might you offer that would accomplish what you would like to see in the way of a disposition association framework and yet give certain auditing parameters to GAO or some other Federal institution wherein there is something there in the way of a check and balance as to the disposition and management decisions that take place within the framework?

Mr. McAllister. Well, of course, the FADA is chartered as a Federal savings and loan, which subjects it to a considerable amount of scrutiny both from the FSLIC and other regulators.

It would be my opinion that those oversights are sufficient to protect against any of the instances you're concerned about.

Mr. McCandless. In the current framework of the daily operation of these-

Mr. Mcallister. It also has a very well thought-out conflict of

interest and code of ethics, which is reviewed constantly.

Mr. McCandless. To Mr. Bowman and Mr. McAllister, we have State chartered institutions. We have State regulations governing those State chartered institutions; yet, in the case of many States, they say:

We will issue you a charter only if you have Federal depository

And so there is an automatic limit in there as to the ability of the Federal system to oversee what it's insuring. And as a result, the exposure becomes greater.

How do we solve this problem?

Mr. Bowman. Well, Mr. McCandless, I am one of those States. I will not issue charter and allow it to open for business unless it has Federal insurance—as a matter of public protection, frankly. And I think the dual oversight maintained by my department and by the Federal Home Loan Bank in insuring those institutions is sufficient on today's market.

And I will submit to you that the problems that we've heard about here today, the nightmare problems that we've heard about, have occurred during changes of ownership in the period from 1982 to 1984. And that since that time—for example, not until last year did my department have the right to even turn down a change of control for a State chartered savings and loan association.

We now have that authority and we have kept a number of people who we consider to be—I believe the term was used, well, at

any rate, entrepreneurs from the system.

Chairman St Germain. Use the term. Use the term.

Mr. Bowman. Well, let's see. Somebody used it earlier and it was beautiful and I wrote it down. And I've lost it somewhere. Let's just say they were half-liars.

But, at any rate, we have kept a number of those people out. And the new charters that have been issued in the State of Texas in the last 4 or 5 years do not represent problems in any instance.

These were associations that were of a size to be attractive to the buyers back in the early eighties, when the word "deregulation",

frankly, gentlemen, was misunderstood.

An entrepreneur in California who wanted to suddenly inject himself into the Texas mystique would come down there and buy a savings and loan association, which he then believed he could oper-

ate with impunity and with very little oversight.

Unfortunately, in some cases, that appears to have been true. And these things got out of hand. But I will tell you this, that we do need a little more resolve, frankly, on the part of the Justice Department as it relates to punishing some of these people; because we can only do our job up to a certain level and then it becomes their responsibility to see to it that white collar crime is punished in this country.

Mr. McCandless. Mr. Chairman, may we have Mr. McAllister

respond?

Mr. McAllister. I'd be happy to respond to that question if you

want.

Well, obviously, we wouldn't be here today if the FSLIC insurance considerations of State-chartered institutions were not a concern. I would just observe to you that, over the long haul, the benefits of the dual chartering system has resulted in financial innovation and change in the system and has served our consumers well. And I would hate to see that system sacrificed in any way.

Mr. McCandless. Thank you. My time is up.

Chairman ST GERMAIN. Mr. Bowman, as to change in control, do you communicate with—is it Mr. Sexton who is your counterpart for commercial bank?

Mr. Bowman. Mr. Sexton has retired now. Mr. Littlefield is. Yes,

we do.

Chairman ST GERMAIN. Well, OK, you do. So you know if there's a high flyer who's been high-flying with commercials. And then if his name shows up as wanting to acquire a couple of S&L's, you can use that knowledge. And you are given that knowledge?

Mr. Bowman. Yes, sir, that's correct. Chairman St Germain. Thank you.

Ms. Kaptur.

Ms. Kaptur. Thank you, Mr. Chairman. I want to thank the chair also for holding expeditious hearings on this matter. I come from the State of Ohio. We've had our own insurance problems in the recent past.

I wanted to take the opportunity to ask the witnesses for my benefit—I've tried to get through some of the testimony. I wasn't able

to hear directly.

Your recommendations on the one or two most significant, specific actions you think this committee could adopt to avoid Texas Life situations that are due to economic downturns and what sounds like some gross mismanagement also in the future, you've made a whole series of recommendations.

Could you prioritize them for me? Perhaps starting with Mr.

Green, Mr. Selby?

Mr. Green. My first would be immediate passage of the FSLIC recap bill. And, second, to include in that an ability of the regulator to define safety and soundness. I think that those would be my top two priorities.

Ms. Kaptur. Do you agree with that, Mr. Selby?

Mr. Selby. I agree, yes. I agree.

Ms. KAPTUR. What about Mr. McAllister and Mr. Bowman?

Mr. McAllister. One of the things that I would like to see is a greater reliance, which is already occurring, on the supervisory capacity in the system. I think, when we reflect back on the period, that this Bank Board will find that they had to attack through regulation items that would have been more adeptly handled through supervision.

So I think a continued enhancement of the supervisory capacity is called for. I think we had cases were we got behind in that area,

some of these institutions that had problems.

Ms. KAPTUR. I wanted to pursue that. How was it, as I read through case A and case B, how was it that the super growth in some of the mismanagement and so forth, why wasn't it caught?

Mr. McAllister. I think it was caught but, initially, they didn't have the regulatory tools. We didn't have the growth limitations regulation. We had a number of items that had been enacted.

Unfortunately, as is always the case, the problem got out a little ahead of the cure. But I do think we've put in place a number of

regulatory initiatives, which will help.

And I think, with the moving the supervisors into the district banks where we can hire a better quality of examiner and the quantity that we need to ensure that these institutions are examined on a regular basis is a huge step in the right direction. And quite likely to prevent the occurrence of what's taken place in Texas from happening again.

Ms. KAPTUR. Do you think we should seriously look at a federally-regulated system of consistent appraisal standards as a part of

that supervisory process in the future?

Mr. McAllister. I feel that the appraisal societies are capable of coming up with those standards and that, in fact, one of the problems that the Bank Board has gotten into is when it's gone over and tried to tell the appraisers how to set appraisal standards, or tell the accountants how to set accounting standards.

And one of the things that I like in this forbearance approach is that it leaves those two aspects to the experts in those fields and then focuses the Bank Board's emphasis on what should be net worth standards and operational procedures. So that everybody stays within their own domain, which I think will serve the industry better over the long haul.

Ms. Kaptur. Mr. Bowman, did you have any comments on my first question, the most significant actions that we might take?

Your priorities?

Mr. Bowman. Yes, Ms. Kaptur. I think the one thing that I would like to see more than anything else is in Mr. Bartlett's bill, and that is to remove FSLIC from its budgetary and personnel constraints so that they can begin to build a structure within the Bank Board, or outside the Bank Board, either way, that can begin to ad-

dress these problems and bring some discipline to the system from

the viewpoint of the Fund itself.

I think it needs to be managed properly. I think it needs to have extremely talented staff, and I think these people need to be paid a career salary, not to look on this as a stepping stone to higher office, but a man who will go in there to seek to solve the problems on a day to day basis and not continually be part of the revolving door that has been the directorship of FSLIC.

Ms. KAPTUR. We have that problem in other parts of the govern-

ment, too, I've learned since arriving here.

Mr. Bowman. Well, I submit to you that the industry will pay the tab. It makes no difference about the budgetary restraints. The savings and loan industry wants to gain the respect of the American public, which it feels we have lost to some extent, and the cost of whatever it takes to make FSLIC operable from a personnel

standpoint, I submit to you the industry will be very happy.

Ms. Kaptur. I also wanted to ask one final question, perhaps to Mr. Selby or Green, whoever wants to comment on this. And that is, if we were to adopt the GAAP recommendations, how would that affect the designation of institutions that you have given us? I mean, you said 56 percent were, or 58 percent were in relatively good conditions. Some were in here. And 9 percent were troubled and disaster—or, yes, here it is on page 8.

I'd like to know if those generally-accepted accounting principles

were applied, would those numbers change?

I'm wondering what the relationship is between the GAAP and——

Mr. Selby. I'm afraid I'm not an accounting expert. And GAAP is a method of financial reporting that's supposed to be a standard-

ized method of financial reporting.

Being a banking regulator and now a thrift regulator, unfortunately, GAAP and the accounting profession does not take into consideration an insurance at the Federal level of the association, because that's part of the whole, you know, the valuation of assets.

If an association has to be liquidated, what is the value of the

asset as far as the insurance fund is concerned?

I don't think GAAP drives the valuation of assets, or would necessarily contradict whatever systems we have of valuating the assets. It's confusing to me, and I'm not an accountant.

But I think part of our problem has been—and the banking agencies have resisted very vigorously GAAP accounting. They also

have had regulatory accounting, and they still do it.

For instance, they do not allow good will in unlimited amounts be counted in capital of the associations; they restrict.

Chairman ST GERMAIN. The time of the lady has expired.

I'm now going to call on Mr. Roemer. Before I do that, I want to state that, once he completes his questioning, we will recess for 10 minutes to vote on the approval to the journal of yesterday's record. Then we will return and resume with this panel.

Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman. I'll keep it short. Three questions. One to Mr. Green.

As I understand it, you support FSLIC recap and a forbearance proponent?

Mr. Green. There are many elements, Congressman Roemer, of the forbearance that I am very supportive of. As, you know, a practical matter, I would hope that the Congress would give some guidance, but that the Federal Home Loan Bank Board would be responsive in the regulations to those items of guidance.

Mr. ROEMER. I hear you. I'm not trying to pin you as to what

exact forbearance.

Mr. GREEN. Yes.

Mr. Roemer. But, a forbearance component?

Mr. Green. Yes, sir.

Mr. ROEMER. OK. If that's true, what does the future look like for you in terms of the number of S&L's in Texas, the hit to the Fund? What can we expect if you get what you wish in terms of legislation? What will the next 2 or 3 years look like, in your opinion?

Mr. Green. Well, the great thing about the FSLIC recapitalization bill would be to give us sufficient funds to go ahead and close those institutions that are hopelessly insolvent.

Mr. Roemer. How many of those are there?

Mr. Green. It's about, as I mentioned in my oral testimony, about 9 percent of the institutions that we feel like are not viable institutions at this time. And those would be over, basically, a number of years.

But, some of those that are the ones that are most hopelessly insolvent, that are in the MCP programs and institutions like that, are complicating the marketplace phenomenonly by paying up for

interest rates, you know, 100-150 basis points above market.

As we get rid of those, it allows that next eschelon of institutions that have been economically depressed to have a better chance to make it, because we would have a phenomenal amount of extra money being made because of not having to pay up because of competitive pressures.

Mr. ROEMER. I understand that, and the point's well-taken. Now, but one of the charges has been, perhaps a mischarge, is that if you get the FSLIC degree cap of the Treasury version, that you will

then post-haste close a number of institutions.

Now, I want you to take a Texas view for me, or you can expand it throughout your region.

Is that true? And give me a number, in your mind.

Mr. Green. Well, we have about 20, Congressman Roemer, 26 or 28 in the MCP program, which are hopelessly insolvent. That would be the primary core that it's my feeling we should work from.

There are maybe a few others that are not in that group now that probably should be, but the great majority are already in the MCP program that we've already identified.

Mr. ROEMER. What will the cost be to the insurance fund if you

do what you just said you would do?

[Pause.]

Mr. Green. I'm estimating that over the 5-year period of time, as we are envisioning the administration recap bill, that we probably could be talking about 5 to 8 billions of dollars.

Mr. Roemer. Just in your regions?

Mr. Green. Yes, sir.

Mr. ROEMER. My God.

Question number two. What about the idea written in the Wall Street Journal and the Washington Post recently about a merger of the two insurance funds?

What's your position on that?

Mr. Green. Congressman Roemer, I'm absolutely opposed to that. I feel like that this would not be in anyone's best interest, either industry nor the public's best interests.

Some of the proponents of this I think are under the false impression that this would mean that they can take the \$16-17 billion that's in the FDIC fund and use that to solve the FSLIC's prob-

lems.

And if this came about, my interpretation of what the head of the FDIC and the Treasury Secretary Gould said was that what we're talking about is merging the regulatory process and not

using bank's funds to solve FSLIC's problems.

And so it's my feeling that the regulatory process that's all housed in one agency, both regulatory, insurance and supervision, is a superior system to what the commercial banks has. And I would want us to think long and hard before we do away with that.

Mr. Roemer. So I'll put you down as doubtful on that proposi-

tion.

Mr. Green. Absolutely.

Mr. ROEMER. OK. My time's expired. Mr. Chairman, I got your question you wanted me to ask, but I can't read your handwriting. [Laughter.]

Mr. ROEMER. OK.

Thank you, Mr. Green.

Chairman ST GERMAIN. The subcommittee will be in recess for 10 minutes.

[Recess.]

Chairman St Germain. The subcommittee will come to order. The chair recognizes Mr. Vento.

Mr. VENTO. Thank you, Mr. Chairman.

Mr. Bowman, today, Mr. Green and Mr. Selby went through three examples that apparently are familiar to you, A, B, C. I see the charts are not here right now.

But, with regards to the association, and you had an association

with those three institutions, did you not?

Mr. Bowman. Yes, sir.

Mr. Vento. And do you disagree with the statements that have been made today by Mr. Green or Mr. Selby with regards to the Federal Home Loan Bank Board disposition and treatment of those? The regulatory process that took place?

Were these State chartered institutions? Were they not?

Mr. Bowman. A and B were State chartered institutions. C is fairly characteristic of several associations, and I'm not sure which one that one represented.

Yes, sir, A and B were both State chartered institutions.

Mr. Vento. Do you agree with the summation that has gone on with regard to these institutions?

Mr. Bowman. You mean do I agree with the way the FSLIC handled the cases?

Mr. VENTO. Yes.

Mr. Bowman. Well, Mr. Vento, this is like a question that was asked by Mr. Barnard on the Empire case: If I had it to do all over

again, would I do it the same way? And the answer is no.

I think we had to learn from both these cases. I think the FSLIC action in both of these associations could have taken place much sooner than it did. However, it would have happened prior to Mr. Green or Mr. Selby's affiliation with the Dallas Bank.

In my opinion, Association A festered far too long before anything was done. Association B was handled probably about as fast

as it could have been.

So I would say that with regard to A, it was handled too slowly, in my opinion; and, B, I think it was probably handled as fast as

the regulatory process would allow.

Mr. Vento. Mr. Bowman, you seem to be suggesting that there is an area of subjective judgment involved in some of the regulatory decisions, a substantial area of subjective judgment that's involved in the regulatory decisions.

Mr. Bowman. Well, I think that's true in the case of A, yes, sir.

Mr. Vento. The Empire case is a case that you were involved with and that had assets that totalled \$12 million. By December 1983, its assets had grown to \$315 million. In 1981, they were \$12 million.

And by the time they got done, they exceeded their book value by 45 percent. Is that the Empire case? This is as reported by the GAO to us.

Mr. BOWMAN. Yes, sir, that's substantially correct. Mr. VENTO. They're going to testify to that today.

And what were the substantial investments in Empire? Were they traditional thrift and loans?

Mr. Bowman. They were condominiums.

Mr. Vento. Construction loans.

Mr. Bowman. Almost exclusively condominiums.

Mr. Vento. Eighty percent.

Mr. Bowman. Six thousand condominiums.

Mr. Vento. Mr. Bowman, in the recent article that I have here from the Dallas Herald article, you were quoted as saying that the Speaker, then Majority Leader, acted properly in delaying the FSLIC bill.

"The people in Washington have the means to destroy the Texas savings and loan industry if we are not careful."

Is this an accurate quote.

Mr. Bowman. Yes, sir.

Mr. Vento. If so, in referring to the "people in Washington", are you referring to the Congress, to the Federal Home Loan Bank Board, or both? Please explain.

Mr. Bowman. I was referring to the Federal Home Loan Bank

Board.

Mr. Vento. In what respect do you believe they have the—what actions did they take that were going to destroy the Texas savings and loan industry?

Mr. Bowman. When I say they have within their power the ability to do it, I'm talking about the liquidation of assets, as I referred

to earlier.

Mr. Vento. Mr. Bowman, given the fact that the Federal Home Loan Bank Board has alleged fraud and numerous other improprieties in certain Texas State Chartered S&L's, isn't the Federal Home Loan Bank Board justified in some of its actions in certain cases? In light of these abuses that have been uncovered thus far? In fact, you referred to the fact that you thought the Justice Department ought to be more aggressive in pursuing some of these issues.

Mr. Bowman. Oh, I take no issue with the fact that we should have taken aggressive action in many cases in Texas. Those cases that involved fraud. Now, they certainly do not reflect the majority

of the problems that we have there today.

They are very dynamic cases and they show well on the charts. But, in fact, that is not the basic problem of the Texas S&L industry today because both the Dallas Federal Home Loan Bank and my department feel we have our hands around the throats of the people who have perpetrated fraud in that industry.

And we do not need to worry about those people any more. Now, we have to worry about cleaning up the mess that they created. But we will not again see a proliferation like we've seen in the last

three or four years.

Mr. Vento. Have you referred these instances to the Federal attorneys in the area?

Mr. Bowman. Yes, sir.

Mr. Vento. Thank you, Mr. Chairman. Chairman St Germain. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. Green, I want to make certain that the committee is crystal clear on something. I think you've said it. You reveiwed and you've testified in general support of most of the items in H.R. 1063, the forbearance and reform.

As I understand, you would have that coupled with the full re-

capitalization.

Are there any provisions that have been proposed under the general generic term, "forbearance", or in H.R. 1063, that, in your opinion, could in any way prevent you from closing those institutions that need to be closed, or from resolving the problems of those institutions that are deeply insolvent and beyond prospect?

Mr. Green. I do not believe so, Congressman Bartlett.

However, I do want to reiterate my feeling that the amortization of loan losses over the 5 to 10-year period is not an appropriate thing because of its departure from GAAP and our need to move in that direction.

Mr. Bartlett. I understand. You oppose amortization of loan losses. You would suggest some ways to streamline the appeals process, although, conceptually, you support that.

And the rest of it, you support. And as I understand, there are

other items of regulatory reform that you would add to it.

Is that correct?

Mr. Green. Well, I think that maybe that you're referring to, you know, many suggestions that have been made in the area of—most of which I think the Federal Home Loan Bank Board has responded to in recent announcements, that the District Banks have

from time to time recommended to the Bank Board just as a policy

matter for their consideration

It's my feeling that, in most of those instances, the Federal Home Loan Bank Board has been very responsive to some of the concerns that we all have about getting as many of those institutions through this very difficult period of time as we possibly can

Mr. Bartlett. Mr. Green, I want you to be you careful about

your words, "very responsive"

Had you recommended some or all of the actions that the Bank Board took last week? Had you recommended those to them in the

past?

Mr. Green. Congressman Bartlett, we have talked about and I have recommended many of those items, and the Bank Board has been, you know, studying those items.

Mr. Bartlett. How long had they been studying them before

they adopted them?

Mr. Green. Well, I think that, you know, things like the asset classification regulation, ever since it's been adopted, you know, there's been considerable dialogue between the district banks and the Federal Home Loan Bank Board regarding that particular type issue. And that has been a number of years.

Mr. Bartlett. That has been for almost a year? In that come

since it was adopted for ---

Mr. Green. Yes. But, let me say that, during that period of time, that we were all gaining experience with this particular near tool of the industry. And I think all of us were very supporting of the fact that this was a tool that the industry needed, or the regulatory process needed very much.

Mr. Bartlett. Well, let me just close as far as that line of it. Had the Bank Board acted with regard to the notawell outer of asset regulation and other net worth winds of reform in a morn timely manner. Would you have been able to better only no

safety and soundness practices in Justicet Y

Would the situation be as bad as it a oday had you had more if a timely change in some of home changes but note made not

week?

Mr. Green. It—corrections such as the dank deard are some plemented. I think had then been tone proviously the success of stitutions probably would have coved better forms or a forcest serious and prevous bases that those would the same a non-corrected upon just in the manner that her same seek on the correctly

Mr. Bartiert. And hat each ne lack to hat let therefore That is, you're telling is hat here to be now in the month that would prevent our comment to a like the plant is seen.

percent you referred of

Mr. Green. That's coment of Mr. Bartlett. Yothing it is

Mr. Green. With, on the state of the state o

Mr. Barriett. Mr. Sources and an active to the current situation of active to the current situation of active to the current situation of active to the current situation.

variously referred to here as high-fliers or others? The 9 percent, or the extremely troubled institutions, the results of aggregious

mismanagement practices.

In your opinion, are the shareholders or management of those institutions still in control? That is, if we were to do something in the area of forbearance, to use a rather broad term that's oftentimes overused, would that have any effect on those aggregious institutions?

Mr. Bowman. Mr. Bartlett, your point's well-taken. The associations that were referred to, I believe, without exception, by Mr. Green, at least those that are State chartered, are all presently

under the supervisory control of the State of Texas.

We have people in those associations. The stockholders have been removed from control without exception, and the people who would profit, the people who would profit from the forbearance in a particular project, in my opinion—and, again, I am not a lawyer—but, in my opinion, the proper management of a project would result in a savings to the FSLIC, and certainly not a windfall to stockholders who have already been removed from control.

Mr. Bartlett. Mr. Green, is that the case with the two examples

you used of Institution A and Institution B?

Mr. Green. I'm not sure that I completely agree with what the Commissioner is saying regarding projects. However, you could utilize FASB 15 very appropriately on individual projects. And that I'm very supportive of.

Mr. Bartlett. My time is expired. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Gonzalez.

Mr. Gonzalez. Thank you.

Gentlemen, thank you very much for appearing here.

I think in the case of Mr. McAllister, when he was here with—the U.S. League spokesman, I recognized him quickly, and knowing that he comes from the area that I come from and that he represents probably the largest, now, S&L in Texas, that we should have him, and the Chairman was very kind in recognizing him for unanimous consent request.

But at this point I am looking at it like, well, Lyndon Johnson used to complain bitterly that he fought to death for the 27½ oil depletion and all he got in thanks was cuss words from those 100

percent Republican oil men.

So, you know, the Speaker when he wants somebody to go down there to Texas, well, he will get the real powers that be, and I am

just a little VIP, a very important peon. [Laughter.]

And Mr. McAllister knows that pretty well, and just like my San Antonio Chamber of Commerce, these financial institutions in Texas don't have many—or if they do, they are small—Democrats, and the charges I had heard last October, as we were closing out the 99th, were that the Board was discriminatory and selective in who it wanted to save and who it didn't want to save, and of course that stands to reason.

When you get into this kind of bind, since everybody was sowing to the wind and you are reaping the whirlwind, the case becomes, you know, as to the strong, powerful survive, the others don't.

Has anybody given any thought to what number of minority in-

stitutions are involved here in Texas? Minority savings.

Yes, Mr. McAllister.

Mr. McAllister. I couldn't answer that, but as I look at the statistics of the savings and loans in Texas, it is amazing to me that a number of small to medium size shops are still in quite good shape and that some of the larger ones are in worse shape.

So I think that this forbearance will not just benefit the large institutions. There are going to be a lot of the smaller ones that have served their communities well, that haven't engaged in these speculative practices that will benefit from them.

I can't tell you specifically how many are minority institutions,

Congressman Gonzalez.

Mr. Gonzalez. Well, I have heard all kind of horror stories, but frankly I think in a certain way Texas has kind of been pounced upon. I think if we were to have this same focus of national attention on California, the Texas case would look like a Boy Scout Troop court of honor.

The basic thing we have here legislatively confronting us is this: Are you gentlemen in support of the \$15 billion request for the

recapitalization of FSLIC over a 5-year period?

Mr. Green. I am, Congressman Gonzalez.

Mr. Gonzalez. With no oversight from the Congress?

Mr. Green. Oh, no, sir. In fact, we are supportive of oversight from the Congress through periodic reports, through OMB audits of that process. In fact, we think that—or GAO audits—we think that should be, you know, a continuous process, sir.

Mr. Gonzalez. But we have had that all along. We were assum-

ing we had it.

I saw the article that appeared in the Texas last week attributed to you, Mr. Green. It was a pretty devastating assessment.

Is \$15 billion going to be enough, and what is going to be the

composition of this board 3 months hence?

It is in a state of flux. Nobody knows who is going to be there and much less who will be Chairman in less than 3 months.

I have had some spokesmen for part of the industry suggesting that the Congress grant considerably less on a 2-year hold, and the

other is the question of forbearance.

Now, you pointed to Case A, Case B, but I find that even after speaking with the Attorney General of Texas, who was the first one to communicate the complaints, and I requested as of, oh, 5 months ago that I be given just one specific case. None has been forthcoming.

I had a visit with Mr. Bowman about 3 weeks, 3½ weeks ago, and I asked for the same thing, and I haven't seen any real specific case where a pattern or even one instance of discriminatory deci-

sions have been made.

I think that the red-lining charge comes from the fact that potential investors trying to rescue at least some of these outside of the State of Texas are being advised by the Home Loan Bank Board

somewhere that they don't advise it.

Now, whether that is true or not, I don't have any way of knowing, but it seems to me that if we are talking about forbearance there is no way we can write a law that is going to giand the proper judgment valuation processes to the I just don't see how we can do it.

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So the question really reduces itself: is \$15 going to be enough even on a 5-year term or a 2-year term?

And from what you say and what you indicate and what has been said back home in Texas, frankly, I don't think so.

My time is up.

Mr. Green. Mr. Gonzalez, let me just quickly respond and say that the \$15 billion, which was envisioned in the bill, when coupled with the other cash flows of the FSLIC, would give about \$25 billion during that 5-year time for case resolution, and it is our feel-

ing that that would be a sufficient amount to do just that.

To your comment regarding red-lining, let me say that there is a market red-lining to a degree, but let me assure you that my fellow regulators within the industry are not a party to that. They—in addition to feeling honestly that way, they have recently received a directive from the Federal Home Loan Bank Board saying that you in no way will red-line or suggest that any institution not make loans in the Texas area and that they use the same prudent underwriting guidelines that they use across the Nation.

The third brief point is that I would be pleased to meet with you personally at any time at your convenience to talk with you and

your staff about the problems in Texas.

Mr. Gonzalez. Mr. Chairman, may I ask unanimous consent to be allowed one additional minute?

Chairman St Germain. Is there objection?

[No response.]

Chairman ST GERMAIN. The Chair hears none.

Mr. Gonzalez. Well, let me say I thank you very much, Mr. Green, and probably I will be trying to contact you. I am very much—naturally very much concerned.

But the reason I wanted that one additional minute is that what do you do in a situation where you have this kiting in the capitali-

zation structure of these institutions based on land values?

And I think Mr. McAllister will back me up and check me if I am wrong. In my area alone in the 1985, by the end of 1985, land

values had dropped over 40 percent.

What do you do in that case, where you have had institutions that got loaded with land that had been purchased at \$1000 an acre but is put down at \$10,000 an acre and now that the market is gone, you know, seeking its level, what do you do in a case like that?

Mr. Green. Well, for those institutions that are caught where they made a prudent, well-underwritten loan at the time that they made it and are caught in a downturn because of those values, it is our feeling that the new thrust of the Board and our actions say that we support giving those people formal, informal forbearances, whatever, in order to allow them time to come back, for those values to return.

For those people who abused the system and took a \$1000 parcel of land, \$1000 per unit, and made a loan of \$10,000 per unit on it, and it is now down to \$800 per unit in value, we feel that those people must be treated completely differently and that those people are abusing the system and should not be within it.

Mr. Gonzalez. My time has expired, so I will have to submit

some questions in writing.

Mr. Green. I will be glad to respond. Mr. Gonzalez. Thank you very much.

Chairman ST GERMAIN. Gentlemen, we have discussed briefly—I did with Mr. Bowman—the change of control statute and the fact

that it has not been too carefully administered.

Now, there were two S&Ls, Ben Milam Savings & Loan and Mercury Savings and Loan. I am told that both of these associations were placed in a management consignment program in March 1986, which would mean they are now being run by a conservator-ship and therefore are technically open institutions.

Is that an accurate statement, gentlemen? Mr. Selby or Mr.

Green?

Mr. Green. Yes, sir.

Chairman ST GERMAIN. Now, on January 13th of this year there was a United States District Court case that was decided relating to an action brought by Mr. John B. Haroldson. The case identifies this gentlemen, Mr. Haroldson, as the 100 percent owner of the outstanding stock in both associations.

Would any of you gentlemen know when Mr. Haroldson became

the owner of those institutions?

Mr. Bowman. January of 1984.

Chairman St Germain. January of 1984, okay.

Now, in 1976, this subcommittee, under my chairmanship, held hearings in San Antonio, Texas, and we went into the failure of Citizens State Bank of Carrizo Springs. During those hearings I coined a phrase, "the Texas render back bank scheme."

As exhibits during those hearings showed, a number of control groups were identified as individuals who made a practice of acquiring small, either national or State chartered commercial banks, dissipated the assets, and subsequently sold these institu-

tions in a weakened condition.

Now, I have asked the staff to give you some excerpts from those hearings, and if you look at the names appearing on Control Group No. 5, a copy of which has been furnished to each of you, you will observe the name, J. B. Haroldson and J. P. Haroldson, whom I assume is a relative.

Now, shortly after the hearings FIRIRCA was enacted into law. It contained both a change of control title as well as a change of

savings and loan control title.

Now, gentlemen, Mr. Haroldson was already in the hearings as having participated in what was known as a "render back bank scheme." So he had a track record. I am wondering, is there a deficiency in the change of control legislation that precluded or—I can't understand why this man now went from doing this in the commercial bank area to the savings and loan area.

Mr. Bowman, can you help me out?

Mr. Bowman. Mr. Chairman, let me correct my earlier statement.

The approval for Mr. Haroldson's acquisition of that association was written in December of 1982. He actually purchased the association in January of 1983.

In answer to your question——

Chairman ST GERMAIN. The law was on the books.

Mr. Bowman.—the regulatory process, as it related to Control Group No. 5, was set into motion in late 1983 and action was taken by my office by means of supervisory control of the associations that were controlled by Mr. Haroldson in—they were served a cease and desist order and placed under our supervisory control in 1984.

Chairman ST GERMAIN. So in this instance it did work, the

Change in Control Act?

Mr. Bowman. It didn't work as fast as it should have, but it did work, yes, sir.

Chairman ST GERMAIN. Okay, thank you.

Mr. Barnard.

Mr. Barnard. Mr. Selby and Mr. Green, do the institutions need some time to go from RAAP to GAAP? I mean, isn't it somewhat unreasonable to ask them overnight to just completely change their programs?

Mr. Green. You are absolutely right, Congressman. Significant time, I think, is needed to evolve into GAAP. The question this morning was asked about—you know, how are these different in

how they would impact the balance sheet?

Just in the State of Texas alone in the area of those that would have less than positive net worth, according to RAAP we would have 16 percent and according to GAAP we would have 24 percent.

Mr. Barnard. Roy, that is one of the reasons that, in supporting the Bartlett bill, I felt it was not too unreasonable to ask for a writedown of loans, maybe not 10 years, maybe seven years or maybe 5 years, but at least to give some period of writedown because of the fact of the shock of going from RAAP to GAAP, and that was one of the reasons that Mr. Bartlett and I put this in the bill.

Would you or Mr. Selby or Mr. Bowman respond to that? I mean,

do you think that is unreasonable?

Mr. Selby. But we don't have a RAAP now that defers losses.

Mr. Barnard. I see.

Mr. Selby. We do have, I will say—I think in 1983, Roy, when the spread narrowed on the funds and loans the Bank Board allowed RAAP accounting on deferred losses, which became a part of capital of these associations, and if you will look at some of the associations, you will see now that their net worth is still comprised by a large portion of something called deferred losses.

That is RAAP accounting, not GAAP, and so——

Mr. BARNARD. But the practical effect is the same, though, isn't it?

Mr. Selby. If Mr. Bartlett's—if you allowed amortization of loans, then you are going to RAAP; you are not going to GAAP.

Mr. Green. Let me say that an additional complication is the fact that the financial press and other banking regulators, I think, would make such noises about this that I think the general public would be more concerned than they are now and this could possibly exacerbate our problems.

Mr. BARNARD. The only problem I see is we are going from

RAAP to GAAP to ZAAP. [Laughter.]

I mean, after that we are not going to have any, Mr. Chairman. Mr. Green—huh? Well, we are rolling craps all right.

Mr. Green, if the FSLIC bill was in being right now, how much of it would be required to satisfy the Texas situations?

Let's say we got \$15 billion of recapitalization. How much of that

would be required for the area which you supervise in the-

Mr. Green. Congressman, my comment a minute ago, that probably \$5- to \$8 billion over the 5-year period of time was for the Ninth District.

Mr. Barnard. That is your district?

Mr. Green. Ninth District. That is five States as a whole.

You know, I am just guessing that 60 to 70 percent would be required in Texas and a significant percentage of the other in Louisiana.

Mr. BARNARD. Have you calculated how many institutions would actually be closed that are presently under the conservatorship in

Texas? How many would now just be closed outright?

Mr. Green. There are presently in the MCP program 12 in Texas and 14-ish in the other States, and sizewise the predominance of that, dollar valuewise, would be in the State of Texas, and so of those that would be 26 that would be in—

Mr. Barnard. But now they are tantamount to being closed now,

aren't they?

Mr. Green. Well, they are still operating.

Mr. BARNARD. I know that.

Mr. Green. And that is a problem in that they are complicating the interest rate marketplace phenomenally.

Mr. BARNARD. Why can't you all control that?

Mr. Green. Well, that——

Mr. Barnard. You can't tell them what they can pay?

Mr. Green. Yes, sir, and that is a good question, and I would like

to respond to that if I might, in that I tried that.

I felt like that with our supervisory control that we could go in and we could say that you are paying too much for funds, and as we did that we turned an earnings problem immediately into a severe liquidity problem, in that phenomenal masses of money rolled out of those institutions overnight, and we then went to the advance window of our bank to loan them that liquidity that they needed and it got to the point to where they ran out of security.

We then went to the FSLIC and said, will you guarantee this, and the FSLIC was swamped with this. And so basically we had to back off of that, I think, very appropriate approach just because of

the phenomenal liquidity problem that it was causing. Mr. BARNARD. Now, that is only in 26 institutions?

Mr. GREEN. Yes, sir.

Mr. BARNARD. My time has expired, Mr. Chairman.

Chairman ST GERMAIN. Mr. Wylie.

Mr. WYLLE. Thank you, Mr. Chairman.

Mr. Green, to follow up a little on my first question, what were the dates of the examinations which disclosed the severe problems in your case examples A, B and C?

Mr. Selby. Well, in Association A, we, in mid-1984, issued a cease and desist order. So it was acquired late 1982, and in mid-1984, we

issued a C&D.

Mr. WYLIE. Right.

Mr. Selby. Association B, I don't have the dates, but as I recall, we issued supervisory agreements for material violations, I believe, in 1983.

Mr. Wylle. You don't have the dates of the examination?

Mr. Selby. I do not have the dates.

Mr. WYLIE. Does anyone with you have it? Can you supply it for the record?

Mr. Selby. I'm sorry, what?

Mr. WYLIE. I said, is there anyone with you that would know the date, or can you supply that for the record?

Mr. Green. We will be happy to supply that, Mr. Wylie. We ap-

parently do not have that with us.

[Information pertaining to dates of examination which disclosed the severe problems in cases A, B and C can be found in the appendix.]

Mr. Wylle. Your description of what happened was fairly complete, so that was based on some information which I assume was acquired by examination.

How about the third one, then, C?

Mr. Selby. I do not have—I know we have had an examination of that, Association C, in 1986, but I do not have the dates.

Mr. Wylle. You had A in 1984 and B, you think, was when?

Around 1984? You're not sure?

Mr. Selby. Well, in Association A, we examined in 1984. We again examined January 30 of 1985. We then examined January 10 of 1986. Those are the three examination dates of Association A.

On Association B, I do not have the dates of the examination. I do know that two supervisory agreements were placed on the Association. Then a cease and desist agreement was placed on them, and in 1986, a consent merger agreement. I would assume that in 1983 the supervisory agreements were placed through the exam.

Mr. Wylle. Do you have the dates of the two previous examinations before the examination which disclosed the severe problem?

Would that be a matter of record, something you would have?

Mr. Selby. The two previous examinations?

Mr. Wylie. Yes.

Mr. Green. It would not be a matter of record, but we would be glad to supply that and make it a matter of record, Mr. Wylie.

Mr. WYLIE. All right. I thank you very much. I think that might

be pertinent to the hearing.

[Information pertaining to dates of 2 previous examinations requested by Mr. Wylie and supplied by Mr. Green can be found in the appendix !

the appendix.]
Mr. WYLIE. In the two examples of the nonviable thrifts, you state that the extremely rapid growth of the institutions were supported in large part by brokered deposits.

Is that true in all three cases? Mr. Green. In the two cases.

Mr. Wylie. In two. Okay.

Mr. GREEN. Yes, sir.

Mr. Wylie. Now on page 30 of your testimony, you discuss a program that is being implemented in the Ninth District and Eleventh District that is intended to reduce the cost of funds for troubled institutions that are currently paying well above market rates.

As you describe your program, securities dealers purchase a large CD or a series of CDs in a financially troubled institution and then sell participations in these CDs to their retail customers.

Did I describe it accurately?

Mr. Green. Yes, sir.

Mr. Wylie. Does this represent government-sponsored brokered

deposits?

Mr. Green. Well it, in my estimation represents an intelligent use of broker deposits, Mr. Wylie. Those funds—having the Federal Home Loan Bank of Dallas involve itself in the program, using a letter of credit of the bank, fully secured by the participating S&Ls that are the target institutions, their cost of money would be reduced some 60 to 70 basis points and would impact the FSLIC to a lesser degree at the time a final solution is found. And so it seems to me it is an appropriate use of our regulatory mechanism.

Mr. WYLLE. Isn't this the very practice that got a number of thrift institutions in trouble in the first place, that Mr. Gray has

been complaining about?

Mr. Green. The problem at that time was what those funds were going into, Mr. Wylie, and certainly, what you're getting at is—I agree with it 100 percent, but it was a practice of inappropriate or nonexistent underwriting in many of those cases that led to very, very risk assets that, you know, in some cases were changing hands five or six times in a very short period of time. So it was he use of those funds in large quantities that were the abuse of that particular time.

Mr. WYLIE. Thank you. Thank you, Mr. Green. Thank you, Mr.

Chairman.

Chairman St Germain. Mr. Vento. Mr. Vento. Thank you, Mr. Chairman.

Mr. Green, in terms of this concept of forbearance that has been discussed, I note that the FDIC assumes that the capital ratios. They provide forbearance between 5.5 and 4 percent, and in some cases down to 3, where there are good prospects for achieving a success within 12 months.

What will be the capital ratios we're talking about with regard to forbearance going on here? The institutions that you are talking

about extending capital forbearance to.

Mr. Selby. Well, the policy statement on forebearance issued by the Bank Board stated that forbearance would be given on the well-managed institutions down to ½ of 1 percent.

Mr. Vento. Down to $\frac{1}{2}$ of 1 percent.

Now how many institutions are there like that in the Federal Home Loan Bank Board district that you represent, Mr. Green? Well-managed and down to ½ percent, yes. I mean, what is the

magnitude in your district that we are talking about?

Mr. Green. Well, in Texas, institutions that are below 3 percent, there would be a total of 60 institutions representing 22 percent of the institutions that did not have more than 3 percent on a RAP basis?. Now if you go to GAP, there's 71 institutions representing 25 percent of the institutions.

Mr. VENTO. Well, which are you using? Which do you want to

use?

Mr. Green. Well, these regulations would be GAP.

Mr. VENTO. But you're using GAP, aren't you, right now?

Mr. Green. Yes, sir; that's correct.

Mr. Vento. You're using GAP, so you've got 25 percent.

Mr. Selby. RAP.

Mr. Green. RAP, I meant. Using RAP right now.

Mr. Vento. In terms of assets. Now what is the asset quality of the assets of those institutions? How would you describe them? Are they stable? Are they likely to be changed in the short term? I notice that you talk about asset quality, as one of your recommendations to the Federal Home Loan Bank Board. What are the nature of the assets of these institutions?

Mr. Selby. Well, let me just clarify something, though. The forbearance—these are 7—this is just a number. 71 institutions in Texas that have RAP net worth below 3 percent.

Mr. Vento. Yes.

Mr. Selby. The forbearance policy says that we would make a determination to apply the forbearance of capital in those well-managed associations that we would apply to. It doesn't mean all 71.

Mr. Vento. Oh, I understand that the—in terms of looking at the

FDIC, that they've also had some 60 applications nationwide.

Mr. Selby. That's right.

Mr. VENTO. Nationwide, and that they've refused about half of them. So I assume that, and I guess that for the benefit of the committee, that probably half of these would not receive the forbearance. Do you think that that's a logical assumption or not?

Mr. Green. Well, it would depend upon-

Mr. Vento. It's a case-by-case issue.

Mr. Green. Right. Depending upon our assessment of management and our feelings of whether or not it's going to survive.

Mr. Vento. We want to keep the political consensus together

here at least for a little while.

Mr. Selby. Well, I think a good explanation would be my example of Association C that had declined in net worth because of their asset portfolio. They had—27 percent of their assets were nonperforming.

Mr. Vento. Yes. That's why I want to talk about the asset portfolio of these particular institutions, because I think that that's the

key, in terms of what we are talking about, don't you?

Mr. Green. Absolutely.

Mr. Selby. Yes.

Mr. Vento. What I am trying to do is get some sort of a profile. Do you have any profile of the asset portfolio of these institutions?

Mr. Green. Well, in the corridor-

Mr. Vento. I mean, I am trying to understand the amount of

risk that we are asking the FSLIC to undertake.

Mr. Green. In the corridor between Houston and New Orleans, we feel that that area that's been so impacted by the oil down turn, real estate down turn, unemployment, et cetera, there is probably an average of 16 percent reduction in all types of property values. That's single family, more in multifamily.

Mr. Vento. Are these interest-sensitive type of assets, or are they something else that we are talking about? Interest-sensitive is generally what we have had with thrifts, but are these interest-sen-

sitive types of assets or not?

Mr. Green. Some are and some aren't, Mr. Vento.

Mr. VENTO. Well, can you give me any better quantification of that answer?

Mr. Green. Well, I cannot be exact there. Some would be variable rate mortgages that would be basically interest-sensitive. Others are short-term mortgage. In fact, many of these would fall into the category of being a short-term mortgage.

Mr. Vento. Is a lot of this direct investment, as we call it, non-

characteristic investment by thrifts, or not?

Mr. Green. There would be a considerable amount of that.

Mr. VENTO. A considerable amount of that, and I note your statement with regard to direct investment.

Mr. Chairman, my time has run out. Chairman St GERMAIN. Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman. I have two questions. Chairman St GERMAIN. Wait a minute. Wait. Mr. Parris, I'm orry.

Mr. Parris. Thank you, Mr. Chairman. I appreciate your consid-

eration.

Gentlemen, I think it may be helpful, Mr. Green. Would you identify for us the name and the location of institutions A and B?

Mr. Green. Congressman Parris, we feel like that this would only cause all of us a problem. I'd be glad, any time, in closed session to talk about those by name and all the details, but I just cannot see that it would be in anybody's best interest, and the general counsel of the Bank Board has advised me not to.

Mr. Parris. All right. Sir. Well, I'll continue my speculation as to where those are, and I will check with your later. I regret that this clandestine atmosphere has to persist, but I can understand it. Nobody desired to precipitate a run on the industry, and certainly that would not be in the interests of the Nation or any of these institutions.

Let me just ask you, Mr. Bowman. It's been testified too earlier that there are 279 insurance thrift institutions in the State of Texas. \$97 billion worth of assets as of the third quarter. What percentage of those institutions are in 3 percent capital or less?

Mr. Bowman. I will defer to the statement made by Mr. Green. I

believe his statement was that there were 60.

Mr. PARRIS. Well, according to Table 10 of the FSLIC Insured Institutions Third Quarter 1986, less than 0 is 66 and between 0 and 3 percent is 74, for a total of 140. Would you quarrel with that?

Mr. Bowman. No. I'm sure that's correct.

Mr. Parris. Okay. So that's 50 percent. Right? Now of that 50 percent, Mr. Bowman, what percentage of that would you say are in that inadequate capital or insolvent category because of insider abuse, gross mismanagement, fraud, whatever? What percentage?

[A pause.]

Mr. Parris. I only have 5 minutes, Mr. Bowman.

Mr. Bowman. Less than 10 percent, sir.

Mr. Parris. Less than 10 percent because of mismanagement or failures of management to properly supervise or control the business operation?

Mr. Bowman. No. If we are talking about inadequate management as opposed to fraud, I'd say considerably more than that.

Mr. Parris. All right. Mr. Bowman, I said—the buzz words are "insider abuse," which we have replete testimony here from—

Mr. Bowman. That is fraud, in my opinion.

Mr. Parris. I agree with that. Insider abuse, gross mismanagement, fraud, some combination of all of those things. Of that 50 percent of the insolvent thrifts in your State, Mr. Bowman, what percentage of that is because of those factors?

Mr. Bowman. I would say 10 percent. Mr. Parris. 10 percent of the 50 percent?

Mr. Bowman. No. 10 percent of the industry.

Mr. PARRIS. All right. So that would be another 30 institutions, which is more—well, you've got 279 institutions. 10 percent of that is 27.9.

Mr. Bowman. Some of those institutions are Federal associations, and I don't have figures on those.

Mr. PARRIS. Yes, but they are all federally insured, aren't they, Mr. Bowman?

Mr. Bowman. That is correct.

Mr. Parris. So guess who's on the line for the money? It's called "this Congress and the Nation's people." OK?

Mr. Bowman. Yes, sir.

Mr. Parris. So I don't think it serves us much benefit to stand on semantics. We've got a problem here where, in my opinion, we have to deal with this problem ina straightforward way in a public agenda, so we don't create a misperception on the part of the public that there is a condition here that applies to all institutions, which none of us want. Okay?

Mr. Bowman. Right.

Mr. Parris. Now, going back to Mr. Green's comments in regard to your 8 percent, 5 to 8. I'll give you that. Of that, if we raise \$15 billion over, basically, a 5-year period, and I understand that bond leverage and so forth takes the 25, we are talking about \$15 billion in the initial bond program, with the Treasury program. If it is 8, Mr. Green, \$8 billion in your region alone, does that take into account the forbearance costs, the management consignment program costs, things of that kind?

Mr. Green. That is a very important question, and I——

Mr. Parris. Could I have a quick answer, please. I've got some more.

Mr. Green. It does not take into consideration prior costs, but it

points up the fact that we need to act on those immediately.

Mr. PARRIS. But isn't it true, Mr. Green, that of the 30 percent of the industry that is in desperate trouble, it is losing \$2.5 billion a year nationwide?

Mr. Green. That is approximately correct.

Mr. PARRIS. OK. And the total of the balance of the 70 percent of the industry that's at record profits is making less than that \$2 billion.

Mr. Green. That certainly would be case in the district.

Mr. Parris. All right. I was just pointed out by staff, Mr. Green that the Bank Board appointment of FSLIC as receiver for institution, I guess it's A, is a matter of court record, of public information. Is there some reason you can't identify it for us?

It is Association A. That's in page 13 of your testimony, Mr. Green.

Mr. Green. I must say that the general counsel of the---

Mr. Parris. OK. I won't-

Chairman ST GERMAIN. Well, wait a second. Is that the general counsel?

Mr. Green. No, sir, it's not.

Chairman ST GERMAIN. Well, would you look at page 13 of the statement.

Mr. Green. Yes, sir.

Chairman St GERMAIN. The reference to the District Court decision. Would you read it? Mr. Selby read it, originally.

Mr. Green. Yes.

Chairman St GERMAIN. Read it into the record.

Mr. Green. "The United States District Court for the Northern District of Texas recently upheld the Bank Board's appointment of the Federal Savings and Loan Corporation as receiver, noting that the administrative record amply supported the Bank's conclusion that Association A was insolvent and had so dissipated assets as a result of violation of rules or regulations and unsafe and unsound condition as to be in an unsafe and unsound condition to transact business."

Chairman ST GERMAIN. Now does your general counsel really think that after making that statement that your reply makes sense?

Mr. Green. There are other institutions of the same name that there could be some confusion there, and here again, let me reiterate, Mr. Chairman, I would be glad to do this in an executive session with this group immediately following, but I——

Chairman ST GERMAIN. No, thank you.

Mr. Parris. And Mr. Chaimran, I appreciate very much your assistance in this matter. It is always a pleasure to have the Chairman's authority and position behind one in these kinds of endeavors. [Laughter.]

But Mr. Green--

Chairman ST GERMAIN. I'm sorry; your time has expired. [Laughter.]

Mr. Parris. That's because you used about half of it, Mr. Chairman. [Laughter.]

If I might, with your indulgence, just finish my sentence, and I will be brief.

Chairman ST GERMAIN. Yes.

Mr. PARRIS. Mr. Green, this is a public town. This is a public body. Everything leaks around here, including the sinks in the

bathroom. [Laughter.]

Do you really believe that if we sat down with you or walked with you down this hall right after this hearing that in 5 minutes everybody at this table, and I think three-fourths of them probably do, know the institution we're talking about? And I submit to you, very frankly, Mr. Green, I don't mean to put you on the spot, but this is a symbolic expression of the problems of this situation, in terms of FSLIC, of the Federal Home Loan Bank Board, generally. We have simply not been straightforward with the people of this Nation. And if we are looking at a problem in the future, it is be-

cause we will have surprised the people who have put reliance on our integrity as the delivery of financial institution services in this Nation.

Mr. Green. Congressman Parris and Mr. Chairman, my own legal counsel behind me tells me, yes, go ahead and say that this is Western Savings of Gatesville, Texas, which I say to you now, there has not been a final order issued in this particular case. There are other institutions with that same name, that we, you know, are concerned about, and you know, we had thought, you know, that there was an agreement that maybe we would not be pushed for this.

And my apology, you know.

Mr. Parris. I was not part of that agreement, Mr. Green.

Could I ask unanimous consent, Mr. Chairman, just to ask one additional question?

Mr. Gonzalez. Mr. Chairman, will you yield to me at this point

because I think that the witness is being abused?

It's been a precedent to have in camera sessions with the regulators. The chairman will recall, when we first began to express concern with the national situation, we had several meetings in camera with the FDIC chairman, with the Federal Home Loan Bank Board Director and Chairman. And I think it's unfair to single out in this particular case.

Of what benefit is that going to be derived other than, as he says, probably further cumbersome, marginal and innocent at this point,

similarly named institutions.

I don't see any reason why we should insist on specifying one particular institution by name or another. We can make the point without having to do that.

Mr. Parris. Mr. Chairman, I ask unanimous consent for one ad-

ditional question.

Chairman ST GERMAIN. Is there objection?

[No response.]

Chairman St GERMAIN. The chair hears none.

Mr. PARRIS. I wonder, Mr. Green, if you would identify Institution B for us for the record.

Mr. GREEN. No, sir.

Mr. Parris. Thank you.

Mr. Green. I will be glad to in executive session though, sir.

Mr. PARRIS. Thank you. My time is expired and I do appreciate your consideration, Mr. Chairman.

Chairman St GERMAIN. Mr. Roemer.

Mr. Roemer. Thank you, Mr. Chairman.

Back to the question, a broader question, Mr. Green, as to how we got here and how we can prevent getting here again. And the implied and, at times, explicit criticism of the Treasury proposal for Recap, that criticism being:

Why give to this body, your body part of the broader body, \$25 billion, because it's the regulators who helped get us where we are now? And now we're going to give 25 billion to the regulators to

get us out?

You've heard that before. But let me ask the broad, philosophical policy question.

policy question

This Administration, from day one, felt that we ought to deregulate financial institutions. Made a persuasive argument on that behalf, the feeling being, economically speaking, that the institutions would then react to the marketplace more swiftly, more fairly and more accurately.

Let's take Texas. Deregulation swept over the land like a flood tide. At the same time, the price of oil dropped 50-60 percent in a

90-day period of time.

Did the institutions react fairly, accurately and with strength?

The evidence shows they did not.

Question: Do you adhere still to the philosophical underpinnings of this Administration that deregulation is valid, positive and can work?

Mr. Green. Congressman Roemer, I am a great supporter of deregulation. However, that does not mean no regulation. And where there is Federal insurance, there has got to be some regulation that comes along with that, to be sure that the fund is not subjected to

the abuses that, in some cases, have occurred.

Let me say that I do not accept the notion that the regulators caused this. This was caused by many people who were in the business who were unscrupulous operators that caused this thing. And that with the advent of the change of the examiners to the districts, with stronger examinations, with stronger supervision, that we're able to look at this and contain this type thing in the future.

But the advent of deregulation did not bring along additional supervisors and additional examiners like it should have. And that

was a mistake.

Mr. ROEMER. Well, let me push it again. You say we can't blame it on the regulators, and I wouldn't try.

However, it was the regulators' responsibility to monitor the

system. That was not done, was it?

Mr. Green. It's certainly the regulators' responsibility to monitor the system, and that we did not have a force in place at that time that was equipped with expertise and numbers to be able to operate as efficiently as was required in the deregulated environment. That has been changed now.

Mr. ROEMER. You have the personnel, the policies, the procedures and the programs to now monitor this deregulated environ-

ment?

Mr. Green. I genuinely feel that we do.

Mr. ROEMER. Do you think that the criticism of why give back to the regulators something they have already destroyed is invalid?

Mr. Green. Yes, sir, I certainly do.

Mr. ROEMER. Second question. It's been said in Louisiana and Texas, and I happen to live in Louisiana, that the problem is one of energy and that if the price of oil werre to go back to \$30 a barrel, which is possible, then we wouldn't have to have these kinds of meetings.

I don't believe that. Do you?

Mr. Green. Well, no, that there are other basic economic problems that are unquestionably there outside the energy area. However, if you want to look at the one that's had the most single impact on the depressed economy, probably it has to do with energy prices. Mr. Roemer. Thank you. Thank you, Mr. Chairman.

Chairman St Germain. Mr. Gonzalez.

Mr. Gonzalez. Thank you, Mr. Chairman.

The chairman referred to hearings that his subcommittee at that time—I didn't belong to this subcommittee. But, on my request, were held in San Antonio. And the reasons were, basically, there were two reasons.

One, as the chairman very accurately described, it was necessary to bring forth clearly and evidentiarily that there was a need to

perfect legislation. And it was done in a very wise way.

The other was the link between international, cross broder movements of finance and their ability to impact us. However, I think that we only fragmentarily legislated. And so some of us became concerned when we saw the manifestations that were clearly evidenced in those hearings, and which led to prosecutions, and so forth; but which, in my opinion, are negative.

They're not addressing the focal point. And the focal point is setting some kind of order in our financial markets. And we cannot do what the Congress has done, whether it's deregulation, so-called, or whether it's the homogenization of our basic financial institutions,

and not really expect anything else.

When all of this has as a background not one but five money menus that have flagellated this country, beginning with the real estate investment trust, the RITS, which eventually would have to impact the S&L institutions, and continuing with your money market developments in which you were having all within structured financial markets, some regulated by fundamental laws going to the 1935 Banking laws. It's inevitable.

We're in a transition point. The price of oil could go up to \$50 a barrel and it's not going to address this basic question. We still are having to go back in the case of the savings and loan and have

them go back to their point of origin:

Why they were founded to begin with by the Congress; the singular principal intent for the S&L's, which were literally abandoned and the Congress helped with the 1982 Act, which was really the first, most substantial working over of the 1935 Banking Act since 1935.

So what I'm saying is, in the legislation we're presented with

now in an hour of crisis, the two fundamental questions are:

One, will adding \$15 billion to the recapitalization structure of FSLIC really—will it be enough under those circumstances? Without redefining the singular or recapturing the vision that was originally intended for S&L's?

And, second, how can we in this legislature prepare language that will enable you to distinguish between two identical structured—that is, on the ledger books—one, (A) that has the same kind of reserve margin, et cetera, et cetera, on paper; and (B) identical, but one is run by a bunch of crooks and the other isn't?

Now, how can we write into law the ability for you to discern that? This is what I think is a fatal flaw with us trying to write some kind of forbearance language into the law.

Am I correct, or am I way off the mark?

Mr. Green. No, Congressman Gonzalez, you're exactly right. In answer to that two-part question, let me say that, yes, I think the 15 billion, when added to the 10 billion in other forms of premiums, special assessments, et cetera, would be sufficient over the 5-year period of time to take care of the massive amount of problems.

Secondly, you've got to trust someone here. And I think the people that you've got to trust are the people on the firing line down there in the regulatory process—Commissioner Bowman,

myself, down there.

And you've got to clothe us, it seems to me, with the ability to determine what is safe and sound operation? What is a prudent operation?

And in doing so, we can move more I think to a judgmental evaluation of an institution's operation as opposed to strictly the numbers here, which are sometimes smoke and nothing more than that.

Mr. Gonzalez. Well, we've got to write laws as if the devil him-

self is going to administer them, not angels. So that's our difficulty. My time's expired.

Chairman St GERMAIN. Mr. LaFalce.

Mr. Lafalce. Thank you very much, Mr. Chairman.

Gentlemen, I apologize for leaving early this morning, but there was and is another subcommittee of this full committee meeting on

the subject of exchange rates.

Having said that, let me get down to the nitty-gritties. Last Congress, we had a bill very similar to the bill, or identical to the bill before us, and virtually everyone was on board, whether the individual was from Rhode Island, New York or Texas—"Let's get this bill passed, it is of paramount importance.

And so we came back at the 100th Congress and we said, "Let's move fast on this." And then, all of a sudden, everybody said, "Whoa, slow down a bit." You know, what became an absolute imperative in October—the system was going to collapse and fall

apart—became a situation we have to slow down a bit.

And why did we have to slow it down a bit? Well, some of these

individuals advanced arguments:

You're really asking for too much. You don't need 15 billion. Five billion would do. Maybe somewhere inbetween. You really don't need 5 years. Two years would do.

That was the second argument. Another argument was:

Wait a minute now, you can't really trust the regulator with this, so you're going to need some language in it dealing with the subject of forbearance aside from simply new regulations.

And then, under this ruberick of forbearance, rather than just

articulate policy, some individuals might say:

And let's permit amortization of our loan losses over a 10-year period, which would skew the books unbelievably and present a totally false picture, in my judgment.

A whole slew of other things, such as—a number of other things. Let me get down to the nitty-gritties though. What do we need? Do we need a \$15 billion bill? Or would a \$5 billion bill due?

Mr. Selbv?

Mr. Selby. Well, it seems to me that the—remember, I'm new in the system.

Mr. LAFALCE. Oh, you're new in the system, but you're not new to this whole financial services. Come on, Mr. Selby. [Laughter.]

Mr. Selby. It seems to me that the amount depends on several things. It depends on, yes, the projections of what it's going to cost FSLIC.

Mr. LAFALCE. Based upon your best knowledge and information, Mr. Selby, what should we do? Fifteen or five?

Mr. Selby. At least 15.

Mr. LaFalce. At least 15.

Mr. Green?

Mr. Green. Absolutely, 15. Mr. LaFalce. Absolutely 15.

Mr. McAllister?

Mr. McAllister. The industry feels that 2-year review is imperative until we could gain some confidence in how the monies are used. So the industries both at the State level and at the U.S. League level are in favor of the \$5 million.

Mr. LaFalce. I knew the League position.

Mr. Bowman?

Mr. Bowman. Essentially the same as Mr. McAllister.

Mr. LAFALCE. OK, fine.

Mr. Bowman. Well, it's not just the League position. I'll go back to my earlier statement. I think there needs to be discipline built into the FSLIC. And that's the critical thing. The 15——

Mr. LaFalce. Okay. Let's go to the question now. Let's go to some specifics, the subject of forbearance. When individuals said, Well, we ought to do something in legislation to bring about for-

bearance, I said, Of course.

But when I said of course, I meant we ought to come up perhaps with some guidelines that could bring about prudence, appropriate prudence on the part of the regulator; apparently the type of prudence that everybody thought that the FDIC and the comptroller was exhibiting, but was fearful that the Federal Home Loan Bank Board and FSLIC would not; although, by the time this bill becomes law, we don't know who, I mean, the head of the Federal Home Loan Bank Board and FSLIC is going to be.

I mean, by the time this bill becomes law and is operational, we're going to be into August, it would seem to me, and we're going to have a new chairman. So we can't even think of the

present contemporary players.

Now, I have no objection to codifying, if necessary, some regulatory guidelines regarding the concept of forbearance if, in fact, that's needed. I don't know what good that—you know, I don't know how much that's needed.

But I do have some qualms about authorizing 10-year amortiza-

tion of loan losses.

Now, Mr. Bowman and Mr. McAllister, do you want legislative

authority to amortize 10-year amortization of loan losses?

Mr. McAllister. I'd like to speak in behalf of Congressman Bartlett's recommendation on the 10-year amortization. The first thing, the Federal regulators have said that it would hamper their process of regulation.

Mr. LAFALCE. You do want to then?

Mr. McAllister. Yes.

Mr. LAFALCE. Yes, okay. And I take it you do, too, Mr. Bowman; right?

Mr. Green and Mr. Selby, do you have difficulties with that? And if you do have difficulties, may I ask what those difficulties are?

Mr. Green. Yes, sir, I do because of the departure from GAAP, number one. And, number two, the perception in the marketplace out there of funny accounting that I think would not serve the industry well over the long pull.

Mr. LAFALCE. Could we counter with the other side?

Mr. Selby. In addition—in addition, if I can say, on amortization of loan losses, I quite agree that—I happen to be a proponent of accurate financial reporting and I think the public deserves that. And an amortization program really doesn't do it.

But, secondly, a formalized statutory requirement that we amortize loan losses, one, then, you are in a fact giving some relief to the investors themselves. I don't know another industry that if you buy stock in an industry and it goes poof, you've lost your stock ownership.

So you're going to have to do that in amortizing losses that are

there.

Secondly, on the flip side, if you tell us, pick out this association and let them amortize the loan losses over 10 years, then are you also going to tell us we want you to require that association not to pay dividends for 10 years? We want you to have them cut down their compensation for 10 years?

That's the flip side.

Mr. LAFALCE. Could we address the other side of the amortization?

Chairman ST GERMAIN. I'll tell you what. Mr. Bartlett is being called upon next. Through some strange, intuitive feeling that I have—I'm gifted with that—I wouldn't be a bit surprised if Mr. Bartlett would ask you to address that. [Laughter.]

Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. McAllister, I am going to ask you to address that. But I might just say by way of comment that the fact is we find ourselves today, in early 1987, in a rather imperfect set of regulatory accounting practices. We've had regulatory accounting practices that, at least for the last some period of time, have forced appraisals on to existing loans which have substantially understated the value of those loans and understated the value of the property in an area that would have been inconsistent with GAAP accounting.

So the issue is—in addition to that, we've had a classification of assets regulation that has taken doubtful accounts, doubtful loans and used them to force down net worth in completely different or the opposite of what happens with banking practices as well as

GAAP accounting.

And so an amortization of loan losses is a short-term, one time only attempt to bring the procedures back into reality. And if it takes 5 years or 10 years to do that, to give us an accurate reflection of reality, then we ought to do that.

Mr. BARNARD. Would the gentleman yield?

Mr. BARTLETT. I'd be happy to yield.

Mr. Barnard. Certainly we're not talking about amortizing all losses. I mean, that's not the point. The point is we're not talking about saying this is a loss, amortize it. No, that's not the point.

I think the point is that there are certain losses which could be, as Mr. Selby very well knows, are classified as substandard and the

doubtful category.

Now, if you've got substandard and doubtful and there's some reason to believe that the appraisals, future appraisals, would bring the value up, looks like to me we ought to give those properties time.

Now it looks like to me that instead of saying absolutely no amortization of loan losses, let's work together. Let's see what is reasonable as far as you as the regulators are concerned to say would be a reasonable amortization of loan losses.

Thank you for yielding.

Mr. Barnard. I thank the gentleman for yielding.

Mr. Bartlett. I thank the gentleman for his comment. I would say one other thing, and then I am going to ask Mr. McAllister to comment, and that is, unless-taking how far down we have appraised, unrealistically appraised property below the real value of that property, unless we provide some kind of amortization of loan losses in areas of economic decline, we build into the system a rather severe disincentive for institutions to sell property, if they can obtain market value or higher than market value over future years, because then they would have to suffer the loss immediately. and I think that is what we are trying to avoid.

Mr. McAllister, would you like to comment on that?

Mr. McAllister. Yes, on several items, in behalf of Congressman Bartlett's proposal to amortize losses over a 5- to 7-year period. First, the industry would be content to continue reporting on a GAAP basis, those of the stock associations. It would be a footnote to the statements. It would be something of interest to the regulators. If you adopt this philosophy, these losses are not lost. They are not hidden. The regulators can still readily ascertain the condition of that institution. So I don't think that impairs their ability to assess where a particular institution is at a particular time.

Second, we feel that that should have a cut-off date of, say, June 30 or December 31, so that obviously, it can't be used for future

Third, under the forbearance proposals, it would probably not be available to all members, in that, obviously, there's no sense in the Bank Board allowing this provision in institutions that are hopelessly insolvent. So it would only be available to those institutions that are deemed able to replenish their capital within a reasonable period of time. Thank you.

Mr. Bartlett. Thank you, Mr. McAllister.

Mr. McAllister, I have a question on a different subject. Your testimony was, on behalf of the League of the Texas and the U.S. League, perhaps a bit ambiguous, and I want you to clarify it for us.

Given the state of the industry and the state of the regulatory scheme that we have right now in the forbearance section, do you believe a) that the Bank Board's recommendations of last week went far enough and b) do you believe that Congress, in passing a recapitalization bill, should include a forbearance section?

Mr. McAllister. I definitely think they should include a forbearance section. Hopefully, a number of the technical specifications can be addressed by guidelines from the Congress with implementation from the Bank Board, and hopefully, that process would be completed to the satisfaction of this body prior to the final recapitalization.

As regards your portion on the 7-year amortization, I think that

does need to be specifically addressed by the Congress.

Mr. Bartlett. So what you are suggesting is that we ought to set the tone and mandate these kinds of reforms but then leave the specifics up to regulations themselves?

Mr. McAllister. It is very technical and complicated and will change over a period of time. So I think that would serve every-

body's interests the best; yes, sir.
Mr. BARTLETT. Is that the League's position also?

Mr. McAllister. Yes, I believe it is.

Mr. Bartlett. Both the U.S. and the Texas League?

Mr. McAllister. I think that would satisfy both those organizations.

Mr. BARTLETT. Thank you. Thank you. Mr. Chairman.

Chairman St Germain. It would seem to the Chairman that this panel has been very responsive. We have spent a good deal of time with them. Does anyone have a burning question that they feel would determine the course of democracy?

Mr. Barnard. Mr. Chairman? Mr. Gonzalez. Mr. Chairman? Mr. LAFALCE. Mr. Chairman?

Chairman St Germain. My God, we've got three——[Laughter.]

Okay. We will go-Mr. Barnard.

Mr. BARNARD. Mr. Selby, I know that we cut you off a while ago in answering my question about classification for amortization. That's a pretty good statement, isn't it? Would you mind commenting on that?

Mr. Selby. I'm sorry. I was thinking.

Mr. BARNARD. It appeared to me that you wanted to comment a while ago, when I said classifying the losses and then amortizing those that were the most useful.

Would you care to comment on that?

Mr. SELBY. Well, I-

Mr. Barnard. I thought you were getting ready to tell me that

you already do that.

Mr. Selby. We do. We-you knew what I was thinking, you see. That's why I disagree that a legislative mandate to amortize loan loss is necessary, because I think in the process of classification, you talked about substandard and doubtful, and we use substandard and doubtful, and it does not mandate a charge-off or a reduction of net worth. And I think we do that.

One other thing, though, if I may take one second to point out. There has been an awful lot of talk about the asset classification and the appraisal system resulting in losses. But how about the situation that exists in the industry, where we have associations that are reporting quarterly, net operating losses from an accumulation of bad assets in their portfolio or assets where the borrowers are unable to pay interest much less principal? A financial institution lives on its earnings, as you well know, Congressman. So if they don't have earnings and you amortize loan losses, where are they going to get the money to continue to operate? Amortization of loan losses is not going to save the net operating losses.

Chairman St Germain. Mr. Selby, since we've got these burning

questions-

Mr. Selby. I knew I shouldn't have said anything

Chairman St Germain.—you were talking earlier in response to a question on amortization. I would like you to repeat this, because we can't ask them to read back from the record, this new stuff they have here. They have to go through the tape recorder.

Did you say something about a stockholder, if they were at—do

you want to repeat that? Did I like the switch?

Mr. Selby. I am just saying, if you amortize loan losses by statute, that you are saying to the organization, you have losses, but you don't have to take those losses, except over a 10-year period, well, who does that benefit, primarily? The association? Doesn't it also benefit the investors in the association?

Chairman St GERMAIN. The stockholders, right?

Mr. Selby. Correct.

Chairman ST GERMAIN. And what did you say should be done, if

that were the case, to stockholders?

Mr. Selby. No. I said on the flip side, if you do that, then aren't you going to have to allow the regulators the flexibility of saying, all right, shareholders, we're deferring losses on your behalf, but you also don't get dividends during that period.

Chairman ST GERMAIN. And Mr. McAllister agrees with that? Mr. McAllister. We'd have no objection to that. It's a logical request.

Chairman St GERMAIN. Next burning question.

Mr. Gonzalez. Actually, it's in pursuance of the question or the

point that Mr. Barnard was asking.

We are using this word "amortization." Just precisely what is the mechanics? Suppose you did get a legislative mandate on amortization? What are the mechanics? How do you proceed about amortizing a loss or a debt?

Mr. Green. I am assuming, Mr. Gonzalez, that upon acquisition of a piece of real estate, if that real estate had a value of \$4 million at that particular time, and you had a \$6 million balance on the loan, that there would be a \$2 million loss that you would, in turn, amortize over a five to ten year period. I think that is the concept.

Mr. Gonzalez. In other words, so somebody is going to pick up

the tab, though. Who is going to pay for that?

Mr. Green. The institution would pay for that over a period of time. What would happen is, our proposal would not imply any difference in the financial reporting to shareholders of the institution. As far as the GAP accounting, it would remain the same. The loss would be subtracted from the net worth of the institution immediately; however, for regulatory purposes, it would be considered as if it were amortized over a period of time. So you would have a footnote to those statements. It would not compromise the integrity of the GAP reporting of the institution. It would just be a way that the-the notion is to cushion a shock to the system and absorb it

over a period of time.

Mr. Selby. But wouldn't it also be logical that if you deferred losses, and all during that period of time you had net operating losses, at the end of 5 years, the association is still insolvent, who is

picking up the tab then?

Mr. Gonzalez. It seems to me, Mr. McAllister, and I don't mean to be disrespectful, that what you are describing there is not double entry bookkeeping but quadruple entry bookkeeping, and you still have the fundamental question, how is that regulator, without endangering favoritism, and involving and probably an environment tempting to be corrupted in selecting that which you believe that in amortizing or in forgiving the loss, that you are actually enabling to keep on a gainful operating basis, which I think Mr. Selby's point is very well-taken.

I just don't see it.

Mr. McAllister. I concur that it would be difficult to administer this system without very adequate supervisory overview, but I would point out to you that it is not unlike what's been done in the farm credit system, when a decision was made to amortize losses over 20 years. It is an approach that is not without precedent in dealing with other financial systems within this country.

Mr. Gonzalez. The farm credit system is broke! [Laughter.]

So I don't like that analogy. Anyway, thank you very much. I think you answered very well.

Chairman St GERMAIN. Mr. LaFalce.

Mr. LAFALCE. Thank you, Mr. Chairman. First I want to congratulate Mr. Gonzalez for what I think was extremely perceptive

questioning.

With respect to your analogy to the farm credit system, the Congress just did that in the last Congress. You know what? We didn't even know we did it. And if we knew we did and had to debate upon it, I hope it never would have been done. They permitted up to 20 years. You know what? It's going to make the problems of the Federal farm credit system far, far worse than they ever were and the day of reckoning is going to be much more serious when we have that day of reckoning.

Having said that, I was very positive about the idea of forbearance until I saw this mechanistic formula within it. I thought we were just talking about some policy guidelines that you codify. And I said, sure, okay, fine. But now this mechanistic formula gives me

serious problems.

But Mr. Sleby, reading between the lines of what you said prior to your questioning by Mr. Gonzalez, were you thinking that you're troubled by the act that the Federal Reserve Board may have the statutory authority to prevent banks from paying out dividends when those banks are in a loss situation, but that the Federal Home Loan Bank Board might not have that statutory authority? Or am I just reading too much into what you said? I guess I'm reading too much into it.

Mr. Selby. No, that's not true.

Mr. LaFalce. OK. Does the Federal Home Loan Bank Board, to your knowledge, have the authority?

Mr. SELBY. Yes.

Mr. LAFALCE. All right. Good. Thank you.

Mr. Selby. And I would like to clarify. I was not proposing loan amortization with it.

Mr. LaFalce. I know that.

Mr. Selby. That was not my position. [Laughter.] Mr. LaFalce. I am fully aware of that. Thank you.

Mr. Green. Mr. Chairman, could I maybe beg your indulgence. One point here, because the direction of the questioning has caused me to make this one, I think, very important observation. Basically, we've got two segments out there right now. One segment that is really, for all practical purposes, brain dead, horrendously insolvent. And the net operating losses of those institutions is so tremendous, that it is more than compensating for the other segment of the industry that is a very good segment of the industry that's done their homework, they've prudently underwritten loans, but there is such a phenomenonal drag brought about by this smaller group, but where the losses and the net operating losses, and the hole already is so horrendous. And so in order for this other group to have every opportunity to make it, that horrendously insolvent group must be taken care of through the recapitalization mechanization.

Chairman St Germain. Any further questions?

[No response.]

Gentlemen, your "brief" appearance here is appreciated. There will be possibly further questions in writing to you. As you know, there are those who feel that this legislation is important enough for us to act deliberately but rather speedily, so we would ask that the replies take that into consideration.

Thank you, gentlemen.

Mr. Selby. Thank you very much, Mr. Chairman.

Mr. Green. Thank you.

Mr. GONZALEZ. Mr. Chairman, I want the record to show that we are very grateful to you for your generous and patient recognition of some of us over here in the lower tier. [Laughter.]

Chairman St Germain. How is it down there, Henry? [Laughter.] Mr. Gonzalez. Well, I've been accustomed—you know, when you sleep on the floor already, you don't fear about falling out of bed. [Laughter.]

[Applause.]

Chairman St GERMAIN. I'm not going to touch that one!

Now if you would repair, and your staffers repair in an orderly, quiet, silent fashion, we have another panel, and we are going to call the other panel up right now.

I hope the entire Home Loan Bank Board doesn't leave, you

know.

Those who are the witness table, please leave.

Mr. McAllister, I would like to proceed with this hearing. Thank

you.

Chairman ST GERMAIN. The next panel consists of Mr. Wayne Nolan, Chairman, C. L. Nolan Savings and Loan Mortgage Company, Fort Worth, Texas; accompanied by H.R. Robert Frenzel, President and author—whoops, wrong list. Thank you.

Panel number two, Frederick D. Wolf, Director, Accounting and Financial Management Division, GAO; David Peterson, Phoenix,

Arizona, President, Society of Real Estate Appraisers; accompanied by Dr. William Kinnard, Storrs, Connecticut, President, Real Estate Counseling Group of Connecticut; John Corzine, Senior Partner, Goldman-Sachs and Company, New York, NY; Roslyn Payne, President and CEO, Federal Asset Disposition Association, San Francisco, California; Dr. Lionel J. Nowotny, President, Watson and Taylor Realty Company, Dallas, TX.

What's that? We have somebody missing? For whom?

[Pause.]

Chairman ST GERMAIN. The subcommittee will come to order. We will hear from our first witness, Mr. Frederick Wolf, Director, Accounting and Financial Management Division, GAO. We'll put your entire statement in the record and you may proceed.

STATEMENT OF FREDERICK D. WOLF, DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, GAO

Mr. Wolf. Thank you, Mr. Chairman, Members of the Subcommittee. Since you have received our complete testimony, I would just like to briefly highlight some of the issues which we have raised here today.

First, our testimony discusses the condition of the savings and loan industry. Since 1983, FSLIC has observed many institutions encountering problems, resulting, among other things, from having to absorb substantial losses on high risk, nontraditional invest-

ments, the so-called asset quality problem.

The outcome has been an alarming number of S&L failures. From 1981 to 1986, all savings and loans were either merged with other institutions or were liquidated, and the number of insolvent savings and loans has increased from 16 in 1980 to over 400 as of September 1986.

It is important, however, to point out that a substantial segment

of the industry is both solvent and profitable.

As of September 1986, about 85 percent of the insured S&L's were solvent, and they earned something on the order of \$7 billion in 1986, while 15 percent were involvent, and those 15 percent incurred losses of something like \$5 billion in 1986.

Although a number of S&L's are insolvent or nearly so and highly unprofitable, they continue to operate. At September 1986, 445 operating S&L's had a GAAP net worth of zero or less, and 300

of them were unprofitable.

In an attempt to preserve FSLIC's resources, the Bank Board has been forced to allow S&L's to operate, even though many may

never regain solvency or profitability.

FSLIC has also had to provide about \$7 billion of assistance to these troubled institutions. Delaying necessary regulatory actions, including closures where warranted, only increases the ultimate cost of resolving the industry's problems.

The majority of current cases requiring action are asset quality problems rather than interest rate spread problems. Asset quality problems are potentially more expensive to the fund and they can

be more difficult to deal with.

Moreover, in contrast to interest rate spread problems which improve when inflation declines, an S&L with asset quality problems

is less likely to recover simply from a return to economic prosperi-

ty, especially when inflation also subsides.

Second, our testimony discusses the impact on FSLIC's financial stability of the industry's position. FSLIC's insurance fund has declined during the last 5 years, from \$6.5 billion in 1981 to a deficit position in 1986 of over \$3 billion.

As a part of our audit of FSLIC's 1986 financial statements, we have preliminarily determined that FSLIC needs to establish a liability in the range of \$8 billion to handle cases that will require

action in the near future.

At December 31, 1985, FSLIC had ninety-three cases involving S&L's that it considered to be in serious financial trouble, with significant negative equity and large losses. One year later, the list had virtually doubled to 183.

These thrifts have combined assets of about \$60 billion.

I'd like to now turn for a moment to prior regulatory actions taken to resolve problems. Since the early 1980s, FSLIC has experimented with assorted regulatory techniques, such as relaxing accounting regulations to postpone resolution of problems.

Various industry groups are now proposing further rule changes and a forbearance program as a further attempt to assist the fail-

ing segment of the industry.

We oppose any changes that would weaken accounting and reporting procedures, and firmly believe that S&Ls should follow generally-accepted accounting principles. Relaxing accounting and external reporting rules of depository institutions results in a misleading picture of the true financial condition of the institutions and does not solve the economic problems in the industry.

Congress, the regulators, investors and the general public all need clear and accurate reporting to make the best decisions possible in response to the magnitude of the problems that S&L's face.

One proposal which has been put forth is to allow S&L's to amor-

tize loan losses over a period up to 20 years.

We oppose that proposal, as we did when similar legislation was proposed with the Farm Credit System. Unfortunately, we believe, and our other work has shown, that our S&L's have often been far too slow in recognizing the uncollectable portion of their portfolios.

Thus, to appear to encourage a liberal use of accounting rules related to debt restructuring without acknowledging the related need to continue to evaluate collectability and to take appropriate writedowns just exacerbates the problem.

This also puts enormous pressure on public auditors, who are trying to assure proper financial reporting to the investing public

and to the depositors.

In the past several weeks, a number of proposals have been made for the Bank Board to adopt a policy of capital forbearance. The Bank Board's recent announcement noted that a forbearance policy would be instituted which would be closely patterned after the commercial banking regulatory agency's forbearance program.

The capital forbearance program, as practiced in the banking industry, is a well defined program, primarily intended to provide a temporary moratorium for well-managed banks with sufficient capital to absorb loan losses and with reasonable prospects for recov-

ery.

It is clearly not a program designed to prop up poorly run or insolvent institutions or to mask or minimize financial problems.

We recognize that a similar policy of capital forbearance might

be a useful regulatory tool for the savings and loan industry.

Lastly, let me turn to the recapitalization proposal itself. We have recently completed an analysis of the Treasury, Bank Board proposal to recapitalize FSLIC, and we are releasing our report to the committee at this time on that recapitalization.

Clearly, FSLIC needs additional funds to resolve the large backlog of insolvent and unprofitable S&L's that continue to operate. FSLIC's current inability to deal with the problems facing the industry has had a detrimental effect on public confidence in the

entire thrift industry.

While we did not attempt to determine whether this \$20 to 25 billion being proposed is adequate to finance the resolution of the known problems, our previous work, knowledge of the industry and the Bank Board's own analysis suggest that a smaller amount would probably be too little.

Our analysis does show that the Treasury proposal can raise \$25 billion over the 5 years. We would emphasize, however, that this solution virtually preempts FSLIC's future income stream to deal

with current problems.

Accordingly, if the industry were to suffer further significant declines, FSLIC would not have the funds available to deal with those consequences. Therefore, we believe that Congress should recognize that enactment of this legislation will not necessarily preclude the need for additional infusions of capital at some future time.

Despite these concerns, however, we do not oppose enactment of H.R. 27 because of the urgency we attach to the need for FSLIC to promptly deal with its inventory of failed or failing institutions.

In its deliberations on recapitalization, however, we believe Congress should also consider requiring the industry and FSLIC to limit the industry's ability to enter into the high risk investments and loans which have resulted in some of the problems we're facing today.

In developing recapitalization, this committee has an opportunity to provide the funding FSLIC desperately needs now and to require actions that will reduce the potential that recapitalization will be

required again at some future time.

Mr. Chairman, this concludes my statement. I'd be pleased to

answer any questions.

[The prepared statement of Mr. Wolf and a Briefing Report to **Selected Members** of Congress can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Wolf.
Now we'll hear from Mr. David Peterson, Phoenix, Arizona, President, Society of Real Estate Appraisers.

STATEMENT OF DAVID N. PETERSON, PRESIDENT, SOCIETY OF REAL ESTATE APPRAISERS PHOENIX, AZ; ACCOMPANIED BY WILLIAM N. KINNARD, JR., PRESIDENT, REAL ESTATE COUN-SELING GROUP OF CONNECTICUT, STORRS, CT

Mr. Peterson. Thank you, Chairman St Germain, Mr. Wylie, Members of the Subcommittee.

My name is David Peterson. I'm a partner in Real Estate Science Corporation, Phoenix, Arizona, where I specialize in appraisals of large commercial and income-producing properties. I have been a professional real estate appraiser for 26 years, and have earned the Senior Real Estate Analyst designation, SREA, of the Society of Real Estate Appraisers; and the MAI designation of the American Institute of Real Estate Appraisers.

I am the 1987 International President of the Society of Real

Estate Appraisers, which has over 17,000 members.

The Society's headquarters are in Chicago and we maintain a public affairs office with legislative counsel in Washington. I am accompanied by Dr. William N. Kinnard, Professor Emeritus in Finance and Real Estate at the University of Connecticut.

Dr. Kinnard also holds the SREA and MAI designation and is an

approved instructor for the Society's R-41C seminar.

For the record, R. Howard Sears, lst Vice President of the Society and Rich LeGran, our chairman of Public Affairs, also are present. Both people also hold the SREA and MAI designations.

The Society of Real Estate Appraisers appreciates this opportunity to testify and to provide the subcommittee with technical assist-

ance on appraisal issues relative to these hearings.

The 1980s have witnesses increasing attention on appraisers and the appraisal process from lenders, insurers and Federal regulators. This attention and scrutiny has been a consequence of an unprecedented volume of defaulted and foreclosed commercial and income property loans and accompanying losses.

Many of these losses have been experienced by FSLIC insured

thrift associations.

Origins of appraisal concerns go back to the early 1960s—seventies. Excuse me.

Three important real estate marketing and financial developments occurred. Real estate investment trusts were introduced. The condominium form of ownership became commonplace, and a surge of lending investment activity into construction and develop-

ment projects was begun by financial institutions.

The records of REITs illustrates that the people managing the REITs took few precautions. A major problem was that appraisals were not obtained until after the fact, if at all. During this period, large in-house appraisal staffs were maintained within life insurance companies and thrift associations. They were often regarded as training grounds for fee appraisers.

A problem for the in-house appraisers with the insurance companies was the focus on analyzing an already-determined situation.

Thrift associations at that time were a different matter. Traditionally, they had been required to obtain appraisals for single-family residential loan purpose in advance of closing of the loan.

Thrifts were accustomed to a 3 or 4-day turnaround time for an appraisal. With the new marketing and financial devices, things began to change. In the new environment of REITs, condos and construction lending, time was of the essence. Prompt action was needed for competitive purposes.

Developers initiated the request for appraisal and then shopped the loan package. Appraisers were asked to utilize the conclusion of a feasibility study given them without further independent in-

vestigation of their own.

In the mid-1970s to the early 1980s, rapid turnover was essential for an appraiser to continue to work for a developer or financial institution. If a loan decision had already been made, the appraiser was expected to justify the conclusions of the underwriter/lender.

Many thrift associations transferred their in-house appraisal operations to their service corporations. Some see this as a possible

conflict of interest.

The lender needed certain levels of value to justify loan amounts. Chairman ST GERMAIN. Excuse me. Let me ask you a question.

Mr. Peterson. Yes, sir.

Chairman ST GERMAIN. In-house appraisals. In other words, the thrift has its own in-house appraiser that tells them what the piece of land is worth, the condo or development, or what have you.

The appraisers are paid, their salaries are paid by the thrift in-

stitution that's going to make the loan. Right?

Mr. Peterson. That's correct.

Chairman ST GERMAIN. Does your organization approve of this type of tie-in? Do you have members of your organization who are salaried employees of thrifts, who do the appraising for those thrifts?

Mr. Peterson. Yes, we do.

Chairman ST GERMAIN. How do you ensure that there's no conflict?

Mr. Peterson. We feel our members abide by our Code of Ethics, Standards of Professional Practice. And there's many difficulties sometimes between our members and, say, management of an association whom they work.

But most of our members that I know——

Chairman ST GERMAIN. If there's a real difficulty, who ends up winning the argument?

Mr. Pererson. The boss wins and the appraiser quits.

Chairman ST GERMAIN. Uh huh.

Mr. Peterson. Perhaps.

Chairman ST GERMAIN. And all of these appraisers, they just up and quit?

Mr. Peterson. Well, some of them work on a percentage bases on a split fee arrangement. Now, with the 30-day contract with many savings and loan associations, and, therefore—

Chairman St GERMAIN. I mean, don't get me wrong but it seems

to me that's an unusual situation. Go ahead.

Mr. Peterson. OK. The lender needed certain levels of value to justify loan amounts. During the recession of the mid-seventies and early eighties, lenders found that some borrowers were unable to meet their obligations.

The result was that real estate owned (REO) became very important to some areas, especially among savings and loan associations

that had been eager for development projects and loans.

From its inception during the Depression of the thirties until the 1960s, the watchword of the appraisal industry regarding real estate value was caution. With changing social policy favoring home ownership, the mortgage finance market was altered in the 1960s, a period of growth, increasing inflation and rising property

values produced optimistic projections concerning future growth

patterns.

The deregulation of the financial industry during the past several years has created an atmosphere which has allowed some very aggressive lenders to become involved with creative lending pro-

In many instances, these creative lending programs have led to

substantial overbuilding in some areas of the country.

As problems in mortgage financing surfaced, attention began to focus on the Federal Home Loan Bank Board's appraisal requirements. Changes in the Bank Board's appraisal requirements came about because the Board believed it needed requirements which would help protect the institutions in changing market environments.

As a result, appraisal reports take longer to produce, require more justification and documentation. The costs to the lender or

client have increased substantially in some markets.

The Society of Real Estate Appraisers acknowledges the need for regulatory agency appraisal guidelines. The Society also compliments the Federal Home Loan Bank Board on its efforts to develop requirements to encourage the use of quality appraisals and appraisal reports.

The Society has attempted to respond to the Board's appraisal requirements by developing educational seminars, courses designed

to educate our membership with these requirements.

The Society and other responsible appraisal organizations have standards of professional practice. These industry standards permit

varying levels of documentation to be requested by a client.

In the R-41C memorandum, the Bank Board made a decision regarding the level of documentation it considers appropriate to meet its obligation to protect a FSLIC insurance fund. The Society has offered to assist the Bank Board concerning the application of appraisal standards so that policy judgments can be fully developed.

We have been assured that we will be invited to assist the Board

in the development of future appraisal regulations.

Federal Home Loan Bank Board Appraisal Memo R-41C. R-41C is the latest in a series of internal memoranda which have been issued by the Office of Examination and Supervision of the Bank

Chairman ST GERMAIN. When was it issued?

Mr. Peterson. It was issued September 11, 1986. The memorandum sets forth the standards in reporting requirements utilized by the Bank Board in determining compliance with the appraisal requirements of the Board's insurance regulations.

The R-41 series of memoranda has been in existence since June of 1977. In September 1977, R-41A was issued. Excuse me, R-41A was issued, followed by R-41A.1 in March of 1979.

R-41B was issued March 12, 1982. It was not until mid to late 1984, however, that the requirements of the 41B began to be strictly enforced. This enforcement led to rejection of appraisal reports in the loan files-

Chairman St Germain. Excuse me. Do you have any idea as to why the 2-year hiatus between issuance and enforcement?

Mr. Peterson. No. I never knew about R-41A much less A-1 or B until 1984.

Chairman St GERMAIN. Thank you.

Mr. Peterson. This enforcement led to rejections——

Chairman ST GERMAIN. Excuse me. Since you have accompanying you the fellow who lived next door to Tarland in Rockville from Storrs, I wouldn't want to ignore him.

When did you, Dr. Kinnard, become aware of 41A, A.1 and B?

Dr. Kinnard. Well, Mr. Chairman, I had a very peculiar set of experiences. I was working in Puerto Rico in the late 1970s and the District Appraiser from the New York Federal Home Loan Bank happened to be a very aggressive gentleman who insisted that the specifications of then new R-41 be enforced. So I was indoctrinated rather early.

Chairman St Germain. R-41B or R-41A?

Dr. Kinnard. It was actually preceding that. Just plain——Chairman ST GERMAIN. Because you said R-4lB was enforced.

Dr. Kinnard. No, I'm sorry. That the specifications of memorandum R-41 itself be enforced.

Chairman St GERMAIN. Thank you.

Dr. Kinnard. So I did have some background on that. But, in my capacity as educational consultant to the Society, I was made aware that in early 1984, perhaps as late as June, there was considerable questioning coming from the membership to headquarters.

And it was at that time that we initially recommended the devel-

opment of a seminar to explain it to our membership.

Chairman ST GERMAIN. So it was issued in 1982, but it came to your attention in 1984?

Dr. Kinnard. Yes, sir. As far as the widespread application of

the standard, yes, sir.

Chairman ST GERMAIN. That's not my question. When did you become aware of its existence and the fact that it would be utilized?

Dr. Kinnard. I personally was aware of it early. But the profession, the organization was really not made aware of it until, as I said, approximately mid-1984.

Chairman ST GERMAIN. Well, then let me ask you why such a

hiatus.

Dr. Kinnard. I can only make a conjecture if you'd be interested in that. And I think that——

Chairman ST GERMAIN. Well, that's better than anything else we've gotten.

Dr. Kinnard. My feeling is that it was really not until early to mid-1984 that some serious difficulties were beginning to merge with savings and loan associations in some selected areas.

And that, at that time, an inspection of the loan files by examiners revealed that there were some deficiencies, including either a lack of appraisals or noncomplying appraisals.

Chairman St GERMAIN. Thank you, Dr. Kinnard.

Dr. KINNARD. Yes, sir.

Chairman ST GERMAIN. Would you continue, sir? Mr. Peterson. Thank you, Chairman St Germain.

The enforcement led to rejection of appraisal reports in the loan files of insured thrift associations. Yet, the enforcement of the appraisal requirements and the enhanced educational efforts by the Society of Real Estate Appraisers were not sufficient to remedy valuation and underwriting practices quickly enough to stem the tide of defaults.

The Bank Board issued R-41C in September 1986. R-41C establishes specifications and requirements for a form appraisal format and a narrative report format. It contains a definition of market value and gives requirements for valuation dates and methodology in appraiser qualifications.

R-41C applies to purchases of loans by Freddie Mac. R-41C requirements therefore may be applicable to appraisals on real estate loans originated by lending institutions or mortgage bankers that

are outside the Bank Board/FSLIC system.

The effect of the appraisal guideline has been significant. The positive impact upon the quality of appraisal reports now found in the Federal Home Loan Bank Board system has been dramatic. Greater knowledge of the Board's requirements and its enforcement efforts have tended to raise the level of appraisal practice despite the criticism received from some quarters.

Attention is focused on differences between R-41B and C. We thought it would be helpful to highlight some of the differences,

and they're on page 7 of my testimony.

I want to emphasize one, that new emphasis in requirements that multiple value estimates be developed, presented and property labeled for all proposed construction was an important difference.

They also mention in the report some explicit mention of the possibility of criminal proceedings against appraisers under the terms of title 18 of the United States Code.

Additionally, there are differences in details, specifications and explanation of many individual points between the contents of 41-B

and 41-C. On page 8, I'll highlight several of them.

R-41C applies to all properties regardless of size or price level, including those for which a standard official form is both applicable and acceptable, such as Fannie Mae, Freddie Mac, FHA, VA, and so on.

The time to complete proposed construction must be explicitly es-

timated and supported.

Market conditions expected to exist as of the date of completion, the date of forecast of stable occupany for proposed construction must be forecast.

Still much of the content and substance of 41B and its predecessors remain. The objective of the valuation must still be market value as defined by the Federal Home Loan Bank Board. A self-contained, stand alone, narrative report that apply all three recog-

nized approaches to value are still required.

As appraisers have begun implementing the reporting requirements of RR-41C, some concerns have risen. And these are the time and cost required to fulfill all the requirements of 41C, the necessity of estimating future value, the definition and meaning of value upon completion, and value as if stabilized, the issue of discounting, R-41Cs applicability to single-family dwellings, in that appraisers can become enmeshed in aspects of the underwriting process.

In our opinion, the following changes and clarifications would improve the effectiveness of the Board's requirements. And these are outlined on the bottom of page 9 and the top of page 10 of the testimony.

And a more complete list of the differences in our suggestions is

found on page 14.

The Society of Real Estate Appraisers acknowledges the need for a regulatory appraisal guidelines. The Society has attempted to respond to the Bank Board's requirements with education courses specifically designed to address these guidelines.

We have been unable to achieve all the goals that we have tried to meet; yet, we are still trying. We remain generally supportive of

the concepts underlying the R-41 series.

Also make a comment on the classification of assets regulation. The appraisal process and the classification of assets function are interrelated.

The classification of assets regulation as we understand it requires additional allocation of net worth to cover anticipated capital loss from loans that show a weakness, such as inadequate coverage of debt service.

In June 1986, the classification of asset system established three classification of problem assets, including real estate loans. These

classifications are substandard, doubtful and lost.

An appraisal report that does not comply to R-41C can render the entire loan package substandard. An asset is doubtful that exhibits discernible loss potential where some loss seems very likely.

An asset is classified as a loss when some or all of it is considered uncollectable. An acceptable appraisal may allow for a lesser amount of loss review.

Also comment on FASB-15. As the classification has to do with the valuation of the loan, which is the asset of the lender, appraisers estimate the market value of the collateral for that loan.

Giving a value to the loan is a matter of policy in accounting principles. At what point nonperforming assets start influencing the perception of the safety of the institution by regulators and examiners are policy questions.

In deciding policy, the questions arise. If we had to convert this asset with its underlying collateral into cash, what could we get for

it?

A market value estimate or an appraisal using market value as the objective would give you a value of the collateral. The concept of market value seeks to establish the most probable price in terms of money a property would bring in the open market under conditions requisite to a fair sale of buyer and seller each acting prudently.

In dealing with income property where benefits are to be derived from future revenue, there are forecasts of these future amounts. Those future amounts are generally discounted to the present at a rate of return that the typical purchaser/investor could earn on an alternative competitive investment.

The holding period discount used by an appraiser developed market value should be based upon a market derived discount rate.

In the accounting field, the holding costs to an owner are used, and when that owner is a lending institution, the cost of money is their cost of funds rate.

The cost of funds rate is a legitimate rate to use insofar as the asset is concerned, but not insofar as the collateral is concerned. This is because the only place where the value of that collateral is going to be realized is on the market.

The classification of assets system establishes the necessity to write down a loan. It requires an appraisal of the property. That

appraisal is a market value estimate.

If there were no 41C, we would still have to abide by the uniform standards of professional practice put forth by the Society of Real Estate Appraisers and other appraisal organizations.

Chairman ST GERMAIN. We can put the rest of your statement in

the record.

Mr. Peterson. Thank you, sir.

[The prepared statement of Mr. Peterson can be found in the ap-

pendix.]

Chairman St Germain. Now we'll hear from Mr. Jon Corzine, Senior Partner, Goldman and Sachs, New York. Put your entire statement in the record, and we'll allow you to summarize.

STATEMENT OF JON S. CORZINE, PARTNER, LAW FIRM OF GOLDMAN, SACHS AND CO.

Mr. Corzine. Thank you, Mr. Chairman, Members of the Committee. I appreciate your invitation to appear here, and I'll just by way of background, my name is Jon Corzine, Partner of——

Chairman St Germain. Mr. Corzine, let's check and make sure

that the mike is on, please.

I guess you've got to bring it closer then. It's one of those that got hit by Gramm-Rudman; it doesn't have enough something or

other; juice or whatever. [Laughter.]

Mr. Corzine. My name is Jon Corzine. I am a partner of Goldman, Sachs. I am not the senior partner, unfortunately. I am the Senior Trader in the Fixed Income Securities Division and a member of the firm's Management Committee.

I have held my current position with Goldman for 2 years, before which time I was responsible for the management of our primary dealership. So I am sure you understand the primary dealership is responsible for the underwriting, distribution and secondary market-making for most U.S. government and agency securities, in-

cluding those of the Federal Home Loan Bank.

My role at Goldman is to assess the risk/reward relationships which relate to our fixed income underwriting and trading positions. That responsibility requires that I assess the investment characteristics of many different debt instruments in light of how investors will perceive those same characteristics.

It is from this expertise and perspective that I offer my comments on the potential attractiveness of the proposed financing cor-

poration securities in the marketplace.

Some basic points first, which may appear elementary, but I believe very much bear repeating. That is, that these securities are neither guaranteed by the Federal Home Loan Bank nor the Federal Savings and Loan Insurance Corporation, nor do they have the full faith and credit of the United States Government. And they will be the sole responsibility of the creative financing corporation.

The perspective investor will, therefore, scrutinize these securities with a view to assessing the likelihood of timely principal and interest payments. The greater the risk the investor feels that he will not be repaid some or all of the principal and interest owing, the higher the rate of interest he is going to demand in compensation.

And the higher the rate of interest the financing corporation is obliged to pay, the more it will cost to fulfill its basic mission of

revitalizing the FSLIC.

This scrutiny will be especially exacting in the case of the new financing corporation because the investor will be confronting both the instruments and the corporation that will be issuing them for the first time. The less certain the investor is that the structure put in place is objectively secure, the more difficult the sale will be.

Thus, the underwriters will need to work harder at educating the investor and selling the investment. By "investor", I am referring to the large institutions such as pension funds, insurance companies and trust departments of banks with sophisticated analysts

and researchers.

Each of these investors will have to justify under the applicable Federal, State or fiduciary standards why he or she bought these new instruments in the quantity he did and included them in his

portfolio.

This is particular important given the fact that, in recent years, the investment community has become increasingly uneasy over the credit standing of the securities afforded agency status. Reflecting this changing investor perception, the spreads demanded by investors for agency securities over Treasury's have been volatile among the various agencies and over various maturity ranges.

It is also true that the absolute spreads have tended to widen. I have included an exhibit that would demonstrate some of these characteristics. In general, these changing relative spreads can be shown to coincide with those times of uncertainty associated with (A) the economic viability of the agency in question, and (B) the political commitment of the existing Congress and the Executive Branch to that particular agency's need.

Both of these factors will be closely studied by the marketplace when it establishes initial spreads of the proposed financing corpo-

ration.

Looking first at the economics of the proposal, I believe that the recapitalization proposal put forward by the Treasury and the Fed-

eral Home Loan Bank does have intuitive merit.

In view of the presumed scope of the problem that has been identified, the sources of funding are straightforward. Thrift industry assessments, Federal Home Loan Bank contributions and capital market resources.

Additionally, the program appears expandable if the scope of the FSLIC problems turns out to be larger than anticipated. We still would hope that the bad news is on the table as investors become reluctant participants when faced with unanticipated surprises which will in turn be reflected in spreads.

Moreover, the financing corporation will be structured appropriate for the broadest possible investor base, with agency status for tax treatment, collateral eligibility and SEC exemption. The time

horizon of its charter deals with the long-term nature of the prob-

lem and solution, i.e., 40 years.

The collateralization of principal payments is feasible and should merit investor acceptance. The availability of the FSLIC assessment adds on an important cushion against the uncertainties of unexpected negative cash flows so that the market can look to this feature for interest payment credibility over time.

Finally, the marketplace at most times has a ready appetite for credit-worthy debt issues in the anticipated maturity range of 15 to

30 years.

In short, the program looks marketable on the economic side.

On the second set of issues, relating to the political commitment, the legislation must be seen as long-term and permanent. Any suggestion that Congress will have to revisit this program in the near future—and I suggested 3 to 5 years—either because the legislation terminates of its own accord after a few years, or because the legislation fails in some way to firmly and decisively solve the problems it addresses will have an immediate impact in my view on the effect on the investor's willingness to buy the instruments at an appropriate interest rate.

A Sunset provision or the prospect of further superseding Federal legislation would raise the objective possibility that there will be

an interruption in the repayment of principal and interest.

Moreover, it would raise a subjective fear that the proposed corporation did not enjoy the unqualified support of both the executive and legislative branches.

The more the investor perceives political support in a certain structure to reflect that support, the more likely he is to accept an

interest rate closer to that on a Treasury security.

While I have offered the view that the Treasury, Federal Home Loan Bank program could work in the form proposed, I do believe there is merit in other formulizations. There certainly is a market-place demand for very substantial amounts of zero coupon bonds. The issues for an alternative proposal would appear to be whether the size of the program would be sufficient to solve the problem and whether the cost of the refunding payment of the principal would be too high or burdensome in the long run.

Mr. Chairman, that concludes my prepared testimony. I appreciate the opportunity to testify and would be happy to answer any

questions.

[The prepared statement of Mr. Corzine can be found in the ap-

pendix.]

Chairman St GERMAIN. I think maybe you'd better not let any of your potential investors read into these hearings. [Laughter.]

Our next witness is Roslyn Payne, who is President and CEO of

the Federal Asset Disposition Association.

Ms. Payne, we'll put your entire statement in the record. You may proceed.

STATEMENT OF ROSLYN PAYNE, PRESIDENT AND CEO, FEDERAL ASSET DISPOSITION ASSOCIATION, SAN FRANCISCO, CA

Ms. PAYNE. Thank you, Mr. Chairman and Members of the Sub-committee. I welcome the opportunity to appear before you today

to provide you with information concerning the operations and ac-

tivities of the Federal Asset Disposition Association.

My written statement, which you have for the record, addresses four key topics: (1) a current overview of our operations and activities, (2) the 1987 outlook, (3) our observations and lessons learned from troubled assets to date, and (4) the effects of H.R. 27, a bill to recapitalize the Federal Savings and Loan Insurance Corporation as it relates to our own operation.

Let me briefly highlight these key topics on an overview basis. In an effort to minimize the FSLIC's loss on troubled assets acquired from savings institutions, the Federal Home Loan Bank Board in November of 1985 chartered a new Federal Savings and Loan Association under the provisions of Section 406 of the National Housing Act of 1934. This Association is called the Federal Asset Disposition Association.

All of its stock is owned by the FSLIC, which capitalized it in March of 1986 with \$25 million. The Association has a 10-year charter and no additional capital is anticipated.

The mission is very simple: to assist the Federal Home Loan Bank Board and the FSLIC in the management, workout and ulti-

mate sale of troubled real estate assets.

The Association never takes title to any troubled real estate, but rather acts as a manager and professional real estate consultant to the FSLIC.

Simply put, the Association has become a major FSLIC contractor for asset management. We have dramatically, we believe, improved FSLIC's ability to secure the highest value on loan workouts and on asset sales and to minimize the associated management expense in the interim.

The goal in this process of management, workout and sale is to obtain the highest possible—price on a net present value basis—consistent with sound business operation. The asset management philosophy is to perform these services for the FSLIC with the small staff of professionals who utilize specialized subcontractors as the workload demands.

This "accordian approach" to subcontracting enables us to minimize our operating costs and utilize resources efficiently on an as needed basis, without a large buildup of core staff. It will also enable the Association to close operations when the work is complete.

As of this month, we were managing approximately 1,000 assets with a book value of nearly \$2 billion for 11 thrifts that have failed. If 100 percent of the book value of all of the participation loans were included, the value of these assets would be nearly \$3 billion.

In addition, we are performing asset advisory work for financially troubled institutions that involve over \$1 billion in assets.

I will comment now on our outlook for 1987. We were organized in 1986 so that we could be poised to assist FSLIC under a recapitalization plan with expanded asset management and disposition advice, again, on an as needed basis.

We believe that the operational infrastructure that we have set up combined with our supply of others who can help us, again, as

needed, will make this possible.

We expect that, in 1987, we will focus our efforts on several key strategic issues. The first is in the management and marketing areas. The second is in the refinement and expansion of our operational systems. The third is in the area of legal coordination. And the fourth is being responsive to the FSLIC restructuring effort.

Let me highlight this latter topic. As noted by Federal Home Loan Bank Board Chairman Gray in his testimony before this subcommittee on January 22 of this year, a Bank Board task force is devising plans and procedures to restructure the FSLIC that includes making the best, highest quality use of our expertise in the asset management and disposition process.

We will assist the Bank Board in its efforts and will implement

their resulting recommendations.

Now, what are some of the lessons we have learned since we

have been operational?

We have learned many lessons about the causes of asset quality problems and the mistakes made by thrift industry managers.

Four problem areas are clearly evident to us as asset managers. The first, in many cases, we have seen poor or nonexistent underwriting procedures in these institutions.

Second, we have seen widespread problem participation loans.

Third, a lack of management systems within these organizations themselves.

And, finally, fraud.

In summary, asset quality problems, when seen in these institutions, are relatively recent and have developed when loans were made by thrift managers, many times, unfortunately, lacking knowledge and experience in new lines of businesses.

Such loans were often made on property types that thrift directors and managers were not familiar with. You heard this morning and earlier this afternoon about the differences in the types of assets that have emerged in those institutions identified over the last several years.

In many cases, thrift lenders have often failed to properly ad-

dress borrower quality and credit-worthiness.

As to the proposed House Bill H.R. 27, let me address that now. Chairman St Germain, we support your objective of full audit and review by Congress of the Association. You wish to accomplish this through the use of the General Accounting Office.

We have studied the language of section 7 carefully and we support your objective. We have suggested certain modifications to your staff that we think will more precisely address these goals.

These modifications are characterized into three areas. As to the GAO audit and review, again, I confirm our support of your objective of audit. However, the current language goes well beyond that topic.

By making the Association a mixed-ownership Government corporation, implications of applying this extremely broadbased government corporation status may well effectively erode our ability to achieve the highest values for the FSLIC for troubled assets.

One result may be to apply the Gramm-Rudman-Hollings and OMB budget authority to the Association. We do not believe this to be your or Congressional intent.

What we have suggested to the staff is a modification of this language to provide for full GAO audit and review upon demand, without altering our status.

With this change, you will be able to achieve your objective of GAO oversight and still enable the Association to perform our

asset management and disposition functions effectively.

As to the Sunshine Act, while we do understand and support the underpinnings of the open meeting requirement of the Government in the Sunshine Act, we believe that such a provision would severely restrict and inhibit the ability of our management and board of directors to perform our asset management and disposition duty.

The board of directors, as you heard from one of our board members this morning, openly and candidly discusses the relative strengths and weaknesses of various troubled savings institutions

and real estate markets.

If these discussions were to become public, the ability of the Association to obtain the highest value for troubled assets would plummet.

Moreover, the effect on local communities would be devastating if runs on thrift institution deposits occurred.

Public confidence in the safety and soundness of the savings and loan system would continue to be severely shaken.

We, therefore, Mr. Chairman, strongly endorse deleting this provision of section 7.

As to reporting requirement, H.R. 27 includes a provision requiring quarterly detailed, written reports to the House and Senate Banking Committees on all of our activities and operations. This provision of section 7 is duplicative since, in the same bill, it contains a similar reporting requirement in section 6(E). We are required to report semi-annually and, in some cases, quarterly on the full scope of our activities and operations. These reports are submitted to the House and the Senate Banking Committees as part of a broader report to the Congress by the FSLIC.

For these reasons, the provision, therefore, can be deleted and

the reporting requirement of section 6(E) substituted.

Thank you, Mr. Chairman, and Members of the Subcommittee for your invitation today. Given the magnitude of the troubled real estate assets of past and future savings failures, we believe that the work of the Association can substantially help Congress and FSLIC resolve these problems.

I will look forward to your questions.

[The prepared statement of Ms. Payne can be found in the ap-

pendix.]

Chairman ST GERMAIN. Now we will hear from Lionel Nowotny, President, Watson and Taylor Realty Company, Dallas, Texas. We'll put your entire statement in the record, and you may proceed.

STATEMENT OF LIONEL J. NOWOTNY, PRESIDENT, WATSON & TAYLOR REALTY CO., DALLAS, TX

Mr. Nowotny. Chairman St Germain, Committee Members, my name is Lionel Nowotny. I'm employed as the President of the

Watson and Taylor Realty Company, which has its main office in Dallas, Texas.

My company is engaged in the commercial real estate business, acquiring raw land and then increasing its economic value by executing the many steps in the development process from zoning through construction of income-producing assets.

My company has a portfolio estimated at approximately \$500

million.

You invited me to appear before this committee to share my company's experience as it applies to the issues now under consideration. Specifically, I was asked to summarize my experience in dealing with the FSLIC and the Federal Asset Disposition Association, and then to make recommendations concerning steps that should be taken to promote the stability and the recovery of the savings and loan industry, particularly in those areas experiencing severe economic decline.

First, I will comment on my experience in dealing with the FSLIC and the FADA. This experience has come through continuing relationships with four savings and loan associations which have been placed under supervision.

One of these was subsequently placed into receivership. I'll limit my comments to experiences with the association in receivership.

Chairman ST GERMAIN. Would you give us the names of those associations?

Mr. Nowotny. Yes, sir. They are State Savings of Midland, Texas; Western Savings, Dallas; LaMarr Savings and 1st South FA of Little Rock, Arkansas.

Shortly after the associations' takeover by the Federal Home Loan Bank, my company met to discuss our loan portfolio with FADA in their Dallas offices.

At that time, FADA was informed that a tentative agreement existed which had been structured during the previous 4½ months by approved supervisory consultants.

This agreement could be immediately implemented. The substantial negative impact of delay on my company's ability to conduct

its business was emphasized.

Additionally, the significant size of the total land portfolio owned and the potential for serious repercussions throughout the financial community was stressed as another compelling motivation for timely action.

A first working session was anticipated the following week, as had been agreed. That working session was cancelled by FADA.

More than 2 months past from the time of receivership until another meeting was called by FADA. The meeting was attended with the expectation of hearing their response to the proposal that had been in hand for over 2 months.

Upon arrival at the meeting, FADA representatives stated that their purpose was to say that the previous proposal was of no value and that FADA now had an urgent need for a new proposed dispo-

sition agreement.

No feedback was offered on any points of the earlier proposal and no suggestions were offered on the structure desired in the new proposal, other than an indication that approval of the receiv-

er would not be likely without the injection of cash by the borrower.

Twelve days later, another proposal was delivered. The following day, FADA stated that the new proposal was not acceptable. Again, FADA representatives declined to make a counterproposal.

Nine days later, a letter was delivered by FADA to my offices, which stated certain terms upon which an agreement might be

reached.

The letter highlights several problems that borrowers are experiencing in dealing with the FSLIC and FADA in a depressed econo-

my. Let me cite certain excerpts from this letter. I quote:

"This letter will set forth certain of our concerns with respect to said proposal and will also set forth in a very general sense a preliminary basis on which we would be willing to discuss a workout of these loans." End quote.

Members of this committee, let me tell you that it has taken 2½ months to reach this milestone. At this rate, our company will only be a faint memory before an actual agreement could be reached.

I quote again. Quote.

"Any workout which we would agree to would require the ap-

proval of the FSLIC." End quote.

Since the borrower must deal with an entity which does not have decision-making authority, the process is even more cumbersome and timeconsuming. Decisions can be turned around.

In at least one instance we're aware of, FADA's recommendation to the receiver to honor a funding obligation to a superior lien holder has been denied, and has resulted in the foreclosure today, as I speak, of a loan on which approximately \$16 million in subordinate debt will be unrecoverable by the receiver.

I further quote from the same letter:

"The company looks to the receiver to bear all future financial responsibility and give WNT an extended period of time to allow the problems with the properties securing the loans to work themselves out. As I'm sure you're aware, this gives the receiver little incentive to accept your proposal." End quote.

Gentlemen, when these loans were made, the lender was pleased to bear the financial responsibility to extract the rewards in the form of 50 percent profit participation expected upon disposition of

the assets.

Now that the economic situation is less favorable, the lenders, by being subjected to severe changes in regulatory practices, have been forced to demand renewal terms upon which most borrowers would not have been able to make the initial loan.

Under the current circumstances, time and forbearance are the only means of realizing the maximum return from these loans. Yet, this provides the FSLIC, quote, "little incentive," end quote, to

cooperate.

While FADA has stated the position that the debtor is the owner of the properties, it has refused the opportunity to reduce debt by denying consent to a contracted sale, and has not allowed it to review an appraisal ordered by FADA on another property.

Specifically, a contract was presented on one property which would have resulted in a pay down equal to 110 percent of the prorated debt basis of the parcel to be released. This sale was denied.

With regard to denying the opportunity to participate in the appraisal process, FADA contracted for an appraisal which found a value for a second property that is not compatible with known comparables in the immediate neighborhood.

FADA neither allowed the borrower to meet with the appraiser to review assumptions prior to starting nor to review the appraisal

since its completion.

Now, then what can be done to get the system back on its feet? I suggest that if the emerging situations were being looked at in a logical, businesslike manner, we wouldn't be where we are today.

The regulatory agencies have not merely oscillated, they have slammed from one extreme to the other. First, there was too much deregulation of the savings and loan industry and far too little regulatory supervision.

As a result, a set of lending practices was adopted by the industry which rapidly became understood to be the acceptable norm, having tacit, if not explicit, approval of the regulatory bodies.

Then, as economic changes occurred in some regions and lenders began to experience difficulty, regulators came in and changed all

of the rules for business already in place.

Severe writedowns were mandated by examiners classifying loans. Appraisal standards were significantly altered, resulting in further erosion of the equity base. Lenders were told not to make real estate loans in certain regions. The real estate economy came to a screeching halt with no way out under the existing rules.

What makes business sense is to, first, identify and eliminate the crooks from the system. But recognize that the vast majority of lending institutions and developer borrowers are sincere, honest and professional businessmen. They should be treated as cuh.

Second, recognize that economic conditions may have a strong regional component; a set of rigid regulations cannot practically be made in Washington and then applied uniformly across the coun-

try at all times.

Third, recognize that the real estate market is cyclical. The current system of classifying loans based on appraisals and the change in appraisal methods has caused lenders to suddenly lose substantial portions of their net worth.

An appraisal is merely a snapshot taken at one point in a time in a cyclical industry. Regulatory practices must take this cycle into account rather than cause panic and fire sale liquidation of assets with the resulting economic chaos it causes.

Fourth, don't punish honest lenders. And don't punish honest developers because of poor economic conditions. Help them through

the situation.

Fifth, leave assets in the hands of those most likely to convert the asset into cash and pay the debt. The developers are highly motivated by the desire to make a profit, to reduce debt or even to minimize a potential future deficiency.

No other entity is more motivated to realize maximum yield from the assets. Certainly, the staffs of the regulatory bodies have

no such incentives.

Sixth, eliminate the severe writedowns on assets where reasonable business plans indicate that the debt can be repaid with time. Seventh, allow time for the economic conditions to improve so

that the ultimate value of the assets may be realized.

And, finally, use any new funding approved by the Congress to help the savings and loan associations, rather than to destroy them.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Nowotny can be found in the ap-

Chairman St GERMAIN. That completes the testimony of our panel. Ms. Payne, I think I'm going to let you use about five minutes. You've made a lot of notes. Go ahead.

Ms. PAYNE. Thank you, Chairman St Germain.

I found it interesting in terms of this last testimony because, in a way, I think it's indicative of how our skills are really needed to have a maximum recovery of the assets involved.

Let me indicate that, in the portfolio mentioned here, there are nine assets involved. They are very complicated. In some cases, the

loans are in a third or fourth position and they vary widely.

As well. I would indicate that the borrowings that were originally done included certain guarantees as related to the principals of the company.

I would like to speak briefly-

Chairman St Germain. Excuse me. You know, feel free to let it all hang out. You know, if there's a little problem with clean hands, conflicts, we'd like to hear about them.

Ms. PAYNE. I know of no conflicts. I only know of some very fine businessmen who I think are very good negotiators. And, I want to

be sure that the record reflects that.

This is indicative of the kinds of complicated matters that we do see. I would like to read briefly from several letters that we did send back to the Watson and Taylor Companies and suggest, for the record, that I will supply copies of these so that all may see as well what I'm dealing with here.

The institution, 1st South, was closed on December 4, 1986. And

at that time-

Chairman ST GERMAIN. Which institution are we talking about? Ms. PAYNE. I'm sorry. lst South Savings and Loan of Pine Bluff,

Chairman St GERMAIN. Thank you. And, incidentally, without objection, we will accept the submissions and they'll be placed in the record at this point.

Ms. PAYNE. Thank you very much.

[Letters to Watson and Taylor from Mr. Payne can be found in

the appendix.]
Ms. PAYNE. We were in Arkansas at that time for that activity and returned to Dallas on December 14. On December 16 was the first time that we did meet with representatives from the company. And at that time, we were in fact told that there had been a tentative proposal as negotiated by Watson and Taylor with a representative or consultant for the institution.

And we would also comment that we acknowledge the cooperation of the company in supplying loan and property information.

We noted at that very first meeting, however, that additional financial information from the borrower would be required, specifically the borrower's financial condition. And, in addition to our request at that time, on December 30, we forwarded a written reiteration requesting that information.

To date, there has been no response. During the month of January, we diligently researched and responded to the problems within

the loans as they related to underlying lien holders.

Remember, many of these assets are in tiers of complications. And, in fact, we requested a meeting with certain representatives to discuss the problems and that meeting was held on February 6.

Also during the month of January, there were numerous telephone conversations for the purpose of factfinding. We did reiterate at the February 6th meeting that the proposal which had been set forth earlier by the borrower was not acceptable.

Now, at that——

Chairman ST GERMAIN. Excuse me for interrupting you. What size proposal are we talking about?

Ms. PAYNE. It's a bit over a hundred million dollars. Chairman St Germain. A little over \$100 million.

Ms. PAYNE. Yes, this is a very large, very complicated set of circumstances with—

Chairman ST GERMAIN. And you can't do this in a week or two? [Laughter.]

Ignore that one.

Ms. Payne. No, no, it's a valid question and I would be pleased to supply you some of the information on the detail that would give you a flavoring of it and perhaps would elaborate on why the complex——

Chairman ST GERMAIN. My point being that it is a rather sub-

stantial transaction that you're talking about.

Ms. PAYNE. It certainly is.

Chairman ST GERMAIN. I know a lot of little transactions I've been involved in that take months and months and months.

Ms. PAYNE. Your point is well made, sir.

At the February 6 meeting, it was stated that neither Watson and Taylor nor the company intended to provide any financial commitments to work out the problem loans.

Now we have in fact, recommended to the receiver for this institution, and the receiver has made certain payments to keep certain

of the loans current. And it is very complicated.

I'd like to comment on the letter outlining some of the components of the proposal made, again stressing the complications, of it all.

Basically, what the company proposes to do is for FSLIC to assume the financial responsibility of keeping all of the underlying

loans current as well as taxes and other operating costs.

And, in return, that upon sale certain interests and certain capital would be recovered, but not all. As well, the gentlemen did mention about the 50 percent profit participation that had been originally negotiated with the lender when the deals were done.

We were informed that, in fact, in terms of this restructuring,

that that was not going to be the case.

I find it hard to agree to a proposal in which FSLIC accepts the entire burden for capital funding paid to other lenders and other operating expenses without some ability to recoup those capital

amounts, perhaps in some of the upside on a sharing basis, and to

work it through together.

We have stated that position to the company. As I said, I think that the committee and you, Mr. Chairman, would find that the detailed correspondence would outline that. We are pleased that the company is well-regarded and is professional in its business, and that's why we have taken the tack that we would in fact like to work out a deal.

But I think that a deal has to be worked out that, again, understands the flavoring of not only the economic difficulties of the community, which certainly is the case, but also the possibility that FSLIC can maximize its recovery during this time period in a professional manner.

I will submit the documents for you.

Chairman St GERMAIN. Thank you. My time is expired.

Mr. Carper.

Mr. CARPER. Thank you, Mr. Chairman. Members of our panel, we thank you very much for your joining us today and for your testimony.

Ms. Payne, I'm going to ask you again—I was out of the room for part of your testimony. I'll have a chance to read it in detail later.

Just summarize for me very briefly, please, the changes that you think should be made in this bill as we mark it up in subcommittee and committee.

Ms. PAYNE. I will only address, Congressmen, the three areas that refer to our own Association. The first is in the Congressional intent for oversight. We support that GAO perform this oversight for the Congress. We suggest that GAO be able to come in at any time on demand and see us.

In fact, they have visited us twice and have made a number of inquiries, and we've been pleased to respond to those requests.

I would have that section, however, only deal with the GAO

audit and delete the rest of the language.

The second, as to the issue of Sunshine, we believe it to be inap-

propriate and I would delete that language in its entirety.

As to the third section, on reporting requirements, we believe that to be duplicative and it is already in existence in section 6(E). Thank you.

Mr. CARPER. Thank you. Let me just ask the other members of the panel, do any of you gentlemen wish to comment on those rec-

ommended changes? Good ideas? Not so good ideas? Please.

Mr. Wolf. Yes, sir. From the standpoint of GAO, we don't normally have provisions in laws that say "on demand". FADA is a subsidiary of FSLIC. The normal approach would be that we would do audits of those either when the Controller General deems it appropriate, or when a Member of Congress requests it.

Mr. CARPER. How about some other comments? Anybody else?

Chairman St Ger. 1AIN. Would the gentleman yield?

Mr. CARPER. Yes, sir.

Chairman ST GERMAIN. At this point, I'd like to have it inserted in the record just subsequent to Mr. Wolf's reply to the gentleman from Delaware, a letter dated January 1987 to the Chairman of the Banking Committee, relative to this very point.

Without objection, so ordered.

Mr. CARPER. Dr. Nowotny, maybe you have some comments on those recommended changes by FADA in this legislation?

Mr. Nowotny. I haven't had a chance to review those and I feel,

therefore, my comments would be presumptious at this point.

Mr. CARPER. All right, maybe you'd like to submit something for the record if you think that's appropriate?

Mr. Nowotny. I'd be happy to do that, sir.

[The comments referred to from Mr. Nowotny can be found in the appendix.]

Mr. CARPER. All right, fine. Thank you all very much.

Thank you, Mr. Chairman.

Chairman St GERMAIN. Mr. Parris.

Mr. PARRIS. Thank you, Mr. Chairman.

Mr. Wolf, what would you estimate is the total cost of the resolu-

tion of this problem nationwide as of today?

Mr. Wolf. Let me comment on a couple of things. The estimate that we made of the \$8 billion which we believe FSLIC needs to record at the present time is our estimate, and it's based to a large extent on information from the Bank Board, of the cost to deal with the worst of the institutions that are on the management consignment or the serious problem list.

Excuse me. There's 180 on the serious problem list. And in analyzing the worst of those, we come up with about \$8 billion to deal with them. Those are people that have significant negative equity.

Mr. PARRIS. That's not all of them?

Mr. Wolf. No. That is neither the entire potential problem list nor the entire industry. We have not tried to project to the entire industry what might still come down the road.

We don't think that the \$20 to 25 billion number is completely

out of line, however.

Mr. Parris. If we adopted the Senate version of this proposal at \$7.5 billion, how long would that last if it was energetically utilized?

Mr. Wolf. If you have 7.5 and I presume, I haven't looked at that one recently, but I believe that that does not include the income and other assessments available to FSLIC. You're probably talking about something that they could not use faster than a 2-year period of time.

Realistically, numbers of \$5 billion a year have been talked about and, in fact, that's sort of the schedule of some of the—

Mr. PARRIS. That's what your report says, isn't it? Five billion dollars?

Mr. Wolf. Yes, yes. And I think that's where they——

Mr. Parris. OK. Table 2. Five minutes goes very quickly, Mr. Wolf.

Table 2 of your report. In 1986, the Treasury assumes in its 20 percent loss on disposition in its proposal. In the resolution cost, there's a percentage of assets. What you list in your report.

What is the recent historical level of troubled institutions in

terms of disposition of assets? Can you tell me?

Mr. Wolf. The losses run between 30 and 45 and I think even up

to 50 percent in some instances.

Mr. Parris. OK. So 45 percent is not out of the realm of possibility in terms of historical perspective. Is that correct?

Mr. Wolf. That's correct.

Mr. Parris. And if I understand your Table 2, what you say is, if, in fact, the disposition of resolution cost is the same as we've experienced recently, then the value of the potential demand on FSLIC insurance funds is 50.74 billion of dollars.

Is that correct?

Mr. Wolf. Yeah. I think that the biggest single problem I have with using some number in that range is that sort of assumes that everything is liquidated and it doesn't give us the opportunity to work things out. That's, we think, too high.

Mr. Parris. Worst case scenario. Is that a fair categorization?

Mr. Wolf. Probably, worst case scenario is not quite strong enough for that one. That's worst case plus taking some Draconian measures that probably don't make sense because they cost more—

Mr. Parris. Well, again, Mr. Wolf, I'm trying to cover a lot of

ground in a very quick period, okay?

But it goes back to the same old question, which is fundamental to this entire issue, as far as I'm concerned, and that's severability.

It's been said here by Mr. Green and others that there's 70 percent doing fine, there's 30 percent sick, dead, brain dead, out of it, going down the pike. The question is are we going to drag them all with them?

That's the issue. Okay?

Now, do you believe that the FSLIC problem as we understand the parameters of it today will ultimately require a taxpayer bailout?

Mr. Wolf. Difficult question. If there are further problems that develop in the industry, then there's a distinct likelihood that what we're talking about is not enough. And that's why we support including in this legislation something that restricts speculative type of transactions, because those are the ones that get us in trouble.

Mr. Parris. Direct investment limitations and all of those kinds

of things? Is that where you're going to?

Mr. Wolf. Yes. Yeah.

Mr. PARRIS. With your writedown, your mandated writedown, is

FSLIC now insolvent in your view?

Mr. Wolf. Technically, FSLIC would be insolvent or is insolvent when you make that writedown. Their assets are not as great as their liabilities.

Mr. Parris. They're \$3.8 billion in the hole if they take your re-

quirement?

Mr. Wolf. Yes, something like that.

Mr. Parris. Can they operate on that basis? What do they do? Mr. Wolf. Well, as a practical matter, there's two things you have to look at. One is the cost and the other is liquidity to the institution. They still have some liquidity.

However, if they begin to deal with these institutions that are on

that worst case list, that liquidity is going to go.

Mr. PARRIS. Yes, but that's the problem. And, Mr. Wolf, we have not been dealing with those institutions. We have had forbearance because we've had no opportunity and no ability to deal with them. Isn't that a form of forbearance?

Mr. Wolf. Yes, sir.

Mr. Parris. My last question, Mr. Wolf. You state in the report that FSLIC needs to establish a contingent liability in the range of 8 billion. That's a nationwide figure.

Mr. Wolf. Yes. sir.

Mr. Parris. And yet we've heard Mr. Green from the Dallas Bank say that Texas alone, or the 9th Region, is \$8 billion. Could

What does that mean for those who advocate a \$5 billion program over 2 years? And is that, in your view, a credible and adequate approach to the problem?

Mr. Wolf. Our reaction is \$5 billion over 2 years probably is not going to be adequate. Now I have to qualify that. There's two ways

you can do \$5 billion over 2 years.

One is that you say everything is set up to go beyond that and there's a congressional review, or the other is \$5 billion and that's

it, period, and nothing more provided ever in the law.

Mr. Parris. I'd just like to say, Mr. Chairman, I appreciate very much the GAO's contributions to this entire problem over a significant period of time. I think they'd done a great service. Thank you.

Mr. Wolf. Thank you.

Chairman ST GERMAIN. Mr. Bartlett. Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. Peterson, I want to ask you a question about the R-41 process. In your judgment, is the R-41 appraisal procedure, is it more timely? I mean, does it require more time to obtain an appraisal using R-41? And how much more time if it does; how much more time on a piece of commercial real estate?

Mr. Peterson. Talking about the B and C?

Mr. BARTLETT. Yes. Or, the D, if you have an opinion on that. Mr. Peterson. I'm not familiar with D, but I assume it's similar. Yes, it does. It requires a market study, financial feasibility. And I'll try to get those subjects market share and what their absorption is going to be in the marketplace. And this is what takes the time.

And also they require that you put an as is value on, which may be the value of the land or the improved property. The value upon completion, which may be 6 or 8 months or 1 or 2 years down the road, and then a stabilized value.

Mr. Bartlett. And can you give us some sense on how much ad-

ditional time is required to obtain an R-41 and how much-

Mr. Peterson. It could double the time.

Mr. BARTLETT. And could double the cost cost?

Mr. Peterson. It could double the cost, yes.

Mr. Bartlett. Is an R-41 appraisal necessarily—how would you characterize it as far as its accuracy compared to a more standard

appraisal in the industry, a non-R-41 appraisal?

Mr. Peterson. I think we're talking about different levels of value. That might be one of the difficulties in this whole mess. We say there's low numbers, but the numbers aren't what we consider typically if we were doing an appraisal. It would be just the fair market value of the fee simple title. That would be one number.

But, if under 41-B or 41-C, they're asking for a discount number, which may or may not be fee simple, it could be something less. For example, a house might be worth \$100,000 to the typical buyer. and that's what the market is from what the buyer would pay. If the banker or the other person wants to know what am I going to net out of it? Well, I've got real estate commissions to pay. I've got closing costs to pay. I may have a holding cost time involved in there for it's only worth \$85,000.

Well, the numbers are still the same. What they're asking for is a different number, or is a different type of value. And that seems to pervade this whole mess as far as what number do they really

want?

And what number do they want us to work from?

Mr. Bartlett. If you were in a lender's position, do you think an R-4l appraisal gives you a more accurate look at the property or a less accurate look?

Mr. Peterson. If I were a lender, I might want to know what risk I have and what I'm going to net, do I have to take that asset

back, what can I get rid of it for?

How much am I going to have into it? Then I'll look at my risk from that point of view, which may not be a market value number or the fee simple title, it might be an investment value for me as a lender. I want to know my point of maximum risk.

If I do get this asset back at whatever point in the development process, I'm going to have to hold it for a while. I may have to complete improvements to it. I'm going to have to absorb it over a

period of time, pay commissions, et cetera.

I might want to know that number to make a decision upon. But I don't necessarily want to make a loan on that number because inherent in my lending is a risk I want to take to get my return.

So I think the judgment as to whatever number you require, we can produce, but that is a number from which a decision would be

made on a course of action for me as a lender to take.

Mr. Bartlett. When you make that assessment, and your testimony on page 12—I want to be certain I understand it—at what discount rate are you recommending should be attached to a lender who has taken property back? So it's property that's in the lender's portfolio? Should it be at his carrying cost of funds, or at the opportunity cost?

There's a dispute within the industry and I'm trying to figure

out what your testimony is.

Mr. Peterson. That particular area talks about FASB 15 and if you want to use your cost in funds, you want to value that note, which is the debt instrument to repay the loan, that's one thing.

But if you've got to set the asset or the collateral for that note is the real property itself, it's two different things. If you want to value that note on some accounting basis, you can use your cost of funds rate. That's fine. But that doesn't mean you're going to get that for the real property when they default on that note. Then what you've got is a real property, which is the collateral for that note.

So then you say what can I get for that property? So it's two different items.

You're valuing a note in one instance and here you're valuing the collateral for that loan and that note, in a sense, once there's a default.

Mr. Bartlett. You're saying that the cost of funds is the legitimate place to start?

Mr. Peterson. If you want to value it from a-

Mr. Bartlett. The Bank Board has told me that they require not the cost of funds as the discounted rate, but a much higher number, including entrepreneural costs and a much higher number than the carrying cost of the property.

Mr. Peterson. In that case, they might be wanting you to value the collateral, the end collateral, rather than the note which is the instrument that you would repay the mortgage for, or the trustee. Mr. Bartlett. Thank you.

Mr. Chairman, if I could ask a question of . . . even though my time is about to expire?

Chairman ST GERMAIN. It has expired, but you may.

Mr. Bartlett. Thank you, Mr. Chairman.

My question is twofold. First, can you give us a sense of your-FADA's philosophy on selling property? Is it your intention to try to sell the properties as rapidly as possible? How do you approach that?

Ms. PAYNE. Congressman, first of all, I'd like to indicate that about 75 percent of the assets that we are currently involved in from a management point of view are loans.

And, basically, like our comments here a few moments ago, what we are actively trying to do is to renegotiate those loans in working with borrowers such that ultimately those loans can be repaid.

Now, most people don't recognize that so much of the assets that we're working with are in fact loans and that our work is in deal-

ing with borrowers.

Of the 25 percent or so that are real estate owned by those institutions, we analyze each asset individually and try to determine, given the local economy, given what the marketplace is, when in fact the asset should be sold. We've taken some aggressive steps in trying to lower the cost of holding for FSLIC, so that it would enable FSLIC to have a more flexible approach in deciding what should be done.

Mr. Bartlett. So, in renegotiating with borrowers then, are you saying that your preferred course would be to renegotiate with the borrower and have the borrower continue to own the property?

Ms. PAYNE. That is correct.

Mr. Bartlett. Thank you, Mr. Chairman. Chairman ST GERMAIN. Mr. Nowotny.

Mr. Nowotny. Yes, sir.

Chairman St Germain. From your testimony, it was brought up that you were negotiating on some rather sizable numbers—\$100 million. That's a lot to me. Although, when you talk about the billions of dollars in losses here, you know-

Mr. Nowotny. We consider it very large, Mr. Chairman.

Chairman St Germain. Oh, well, I'm glad to hear that.

Are you really saying that you feel that FADA is slow and inde-

Mr. Nowotny. Let me make a response to that, Mr. Chairman. First of all, I'd like to say that we have enjoyed our dealings with the representatives of FADA and I liken their situation to giving an interne the epidemic to solve. They were organized only a short

time ago, I believe. Ms. Payne's testimony was that they were organized during 1986, and the problem was already very large at that time.

So that what we're dealing with is an organization recently

staffed, which perhaps is still seeking——

Chairman ST GERMAIN. But they are highly trained experts. They're not on the job training people. They're highly trained experts. You know, let's face it. Ms. Payne comes in. There aren't too many people in government—the President of the United States I don't think makes what she makes.

So she's got to have some real background and training. We're

not talking about an intern here, Mr. Nowotny.

Mr. Nowotny. Yes, sir.

Chairman ST GERMAIN. We're not talking about internes here. We are talking about surgeons who have gone through all the chairs. We've got a surgeon here who's one of the finest in the Nation.

Mr. Noworny. That's the first time I've seen Ms. Payne, but—

Chairman ST GERMAIN. But she has great credentials.

Mr. Nowotny. I'll accept that.

Chairman ST GERMAIN. Two hundred and fifty thousand balloons a year, she must have. [Laughter.]

That's big bucks. Do you still want to call her an intern?

Mr. Nowotny. Well, I didn't mean to call Ms. Payne an interne, Mr. Chairman. What I meant to say was that they have been subjected to a very large burden of work and, in fact, we have dealt with some folks who really might not be classified as surgeons, but that would be an exception.

I agree that they're professional and I haven't-

Chairman ST GERMAIN. The people that you dealt with, were

they actual FADA staff, or were they outside consultants?

Mr. Nowotny. We have dealt with FADA staff and their counsel, yes, sir. So I'm not trying to find fault with FADA. What I'm trying to say is that dealing with the organization has been much slower than we had anticipated. It has seemed cumbersome to us.

And as Congressman Parris pointed out, he stressed the need for openness. And that the way the problems are solved is by communication. And I believe you said just a moment ago we should get

things out on the table and wash the laundry.

So far, our experiences at all of the communication has been oneway. We have supplied complete documentation to FADA on our total loan portfolio with that lst South FA because they couldn't get it from their own sources because of disruption of the receiver-

ship, the physical disruption that occurred.

We provided that within 2 days of the initial meeting we had with them. We made them aware of our financial statements that had been provided previously to the supervisory consultant. And what I'd like to point out is that you made light of why can't we solve this in a week or two but, in fact, in my testimony, I said that we had already come to a tentative agreement on the day before receivership occurred with a supervisory consultant when they were under supervision.

Certainly that supervisory consultant was acting with the knowledge of the Federal Home Loan Bank at the time. And, in the

day before receivership occurred, I transmitted what was expected to be the final, final copy of an agreement by which our loan portfolio would be handled.

That agreement did not preclude profits sharing by the lender. In fact, that agreement required that appraisals be taken initially and that those appraisals be matched with the outstanding debt to establish what would be considered a potential deficiency in the future. And that we mark that amount.

And that all proceeds from the sales of properties would go against the debt and against that potential deficiency until such time as it was completedly paid off, before my company took either any profit or paid for their own overhead in continuing to manage and sell the property.

Chairman St Germain. Ms. Payne, the receivership came into being prior to the consummation of the agreement, like consummating a marriage, so to speak. They got to the alter, but they just

didn't finish it.

Then what happened? Then receivership kicks in. And now those assets then go to FADA and it becomes your responsibility; is that

Ms. PAYNE. They are technically owned by the FSLIC.

Chairman ST GERMAIN. By FSLIC.

Ms. PAYNE. That's right. We are now asked to manage those assets.

Chairman St Germain. Right. OK. But, what—just because my time is expired, I just want to get this clear in my mind. What occurred was that there was an agreement in place that was almost complete. However, if FSLIC and FADA then, once receivership kicks in, were to have said, "oh, yeah, we'll buy all that, you know, that work was done, we'll just sign off.'

Then, if it's subsequently determined that there was something wrong, then you would bear the responsibility for actions taken by

somebody else that you've just concurred in.

Am I reading that wrong?

Ms. PAYNE. First of all, I believe, as the Watson & Taylor Company testimony reads, that the agreement was tentative. I don't think that a lot of the details had been flushed out. That's my recall of the document at that time.

In any case, this or others, we would review what is proposed and, in fact, it was correctly stated that a lot of the detail on those

assets was provided to us in a prompt manner.

But it is very complicated, as you've noted. However, certain things were not provided to us, which was an update of the financial condition of the borrower and of the guarantors. These loans were originally made beyond just the collateral of the assets themselves. There were additional collateral in making these loans.

We requested additional information promptly on December 16. And I could be wrong, but I don't think we've gotten it yet, have

we?

Mr. Nowotny. That's correct, you haven't received it. However, after receiving the letter requesting that information, Ms. Payne, there were the two owners of the company and myself, plus two attorneys who were with us in the room with approximately seven of your staff and their attorneys at that first meeting, and not a single one of the five of us ever recall the request on December 16th, but the five of us could be wrong.

Ms. PAYNE. Well, but we did send a letter on December 30th. Is

that right?

Mr. Nowotny. Yes, and we have not supplied additional corporate financial information. That's the only thing that you've asked for that we have not yet supplied. But we haven't received anything, including an indication of how you'd like to deal, from you.

Ms. PAYNE. I think the record will show and I will submit to this subcommittee at least one letter in response to that as part of this

negotiating process.

What I'd like to—

Chairman ST GERMAIN. Excuse me. We're not going to complete this negotiation at this hearing. [Laughter.]

I think we've got the—pardon?

Voice: You've made more progress than we have. [Laughter.]

Ms. PAYNE. I think you have.

Mr. Nowotny. That's correct. Chairman St Germain. Mr. Parris.

Mr. Parris. Thank you, Mr. Chairman.

Mr. Corzine, I'd like to ask you, you say in your testimony on page 4 that you hope the bad news is on the table. Investors just don't like anticipated surprises, and so forth. Do you believe—

Mr. Corzine. That should have been corrected: "unanticipated

surprises."

Mr. Parris. That was part of my question. It's unanticipated surprises that's what they don't like.

Mr. CORZINE. Right.

Mr. Parris. Do you anticipate that there's going to be some of those? You've heard all this testimony today. What do you think?
Mr. Corzine. I find it somewhat uncertain as a potential investor.

Mr. Parris. Right. Other than the rosy scenario, Mr. Corzine, are you still optimistic about the marketability of what I call government junk bonds?

[Pause.]

Mr. CORZINE. I would think that the program that I understand from the Treasury and the Federal Home Loan Bank proposal, H.R. 27, has the flexibility to be extended, given that the earnings, the Federal Home Loan Bank continued to develop retained earnings.

So that I think that it could deal with the larger problem. I do think that you have to be realistic about the scope of the problem. And, certainly, that sounds better than \$5 billion to solve the prob-

lem.

Mr. Parris. It's essentially a function of cash flow though, isn't it?

Mr. CORZINE. Right.

Mr. Parris. Isn't that where we're coming from?

What would you anticipate a risk-related premium above the normal Treasury securities would be in a situation of this kind?

Mr. Corzine. Well, if we had established the market area where you're going to do your financing somewhere in the 15 to 25 year area, I would think that these FSLIC securities or financing corpo-

ration securities in trade, give or take a little bit of Kentucky wins, it's around 75 basis points over the Treasury.

Mr. Parris. Is it fair to say 150 basis points or so above normal?

Would that be a fair range?

Mr. Corzine. No, no, no, no. I think not on the standardized debenture offering by the funding, I would think, would be in the 75 basis points, could stretch out if there is troubled times in the agency markets to as much as 100 basis points. But the structure of this——

Mr. Parris. How much would 100 basis points be in terms of in-

terest for a year?

Mr. Corzine. A hundred basis points on a million dollars is I percent of that. So——

Mr. Parris. We're talking 15, but would it be on the full 25 as

leveraged out?

Mr. CORZINE. The creation of this program would not argue that you would sell \$15 billion, or I would not argue that you—

Mr. Parris. You couldn't do that, could you?

Mr. Corzine. Could not do that at one point in time. It would have to be a funding program that is weeded into the marketplace.

Mr. PARRIS. And what would happen—I'm sorry, Mr. Corzine, but we've got to get going here. Okay?

Mr. CORZINE. Sure.

Mr. Parris. What would happen if we adopted some kind of a program that addressed half of this problem, and then revisited it, as you say on page 5? Would that essentially——

Mr. CORZINE. I think that is going to cost money to the funding

corporation and I think it will make it a less effective program.

Mr. Parris. You say it will have an immediate effect on the investor's willingness to buy the——

Chairman ST GERMAIN. Excuse me. You mean adverse effect.

Mr. Corzine. Adverse effect.

Chairman ST GERMAIN. He just said it would make it a less effec-

tive program. You mean as to salability?

Mr. Corzine. As a salable. And on a marketability. And I think, because you're going to use more for interest costs, in effect, it will have fewer dollars available for the purposes that you want the funding corporation to support the FSLIC. I think that those are the logical extension of that.

Mr. Parris. Dr. Nowotny, you say on page 6 of your testimony: "The real estate economy in Dallas came to a screeching halt with no way out under the existing rules, with writedowns, ap-

praisal standards, et cetera."

In that circumstance, do you support forbearance? Is there any possibility that the asset equality will increase in a hostile market, that it's been called? Will forbearance work?

Mr. Nowotny. Yes, sir, it will in my opinion. I'm convinced that it will.

Mr. Parris. How long will it take the assets to get to market? Mr. Nowotny. The economy is cyclic and we all know that. And particularly in the real estate market. And what we have here is we've gotten a market that's down and we've compounded the problem with other penalties that were not intended to be penalties, but they act in that manner.

I believe that over a period of 5 years, I would expect to realize the revival of the values to the extent that the debt could be paid off.

Mr. PARRIS. Ms. Payne, you say essentially—this is my word—you're essentially warehousing troubled assets for FSLIC and finding the ways to minimize taxpayer losses.

Can we warehouse those troubled assets indefinitely? Isn't there

a requirement to proceed in some orderly disposition of those?

Ms. PAYNE. First of all, again, Congressman, FSLIC always retains title to the assets.

Mr. Parris. I understand. I'm not interested in the details.

Ms. PAYNE. In terms of the management aspects, I do agree with the comments made here that the real estate business and economies around the country do have a pattern of cyclicality. I think that certainly the issue of indefinite holding periods is a difficult concept, but we have historically seen cyclical sectors throughout the economy in different parts of the country as well as in different kinds of product areas.

Mr. PARRIS. Well, that—with all due respect, Ms. Payne, I appreciate your comments but that is so general as to be almost not helpful. And I understand the time constraints and I do not mean

in any way to be critical.

But the problem is this Congress and this committee is faced with a \$5 billion drain and 30 percent of a trillion dollar industry that's going down the pipe.

We cannot deal with broad generalities about the difference of cyclical real estate markets in different urban areas of the Nation.

I mean, it's much too critical for that in my view.

And I have been accused of not looking at the rosy scenario but the worst case, and that's perhaps true. But I don't think so. And I

apologize if anything I've said is offensive to you.

Chairman ST GERMAIN. Mr. Corzine, I take it you know that the definition of "unique" means one of a kind. And your being here is unique because, very frankly, I'm going to say to the committee, it wasn't easy to find somebody to come and testify on this facet of the recapitalization plan.

Now there are those that have been saying that you could do a \$5 billion "pay-as-you-go" or whatever it is plan for 2 years, and then come back and get another \$5 billion, and come back again if

necessary and get another five.

Then there are those, like when Treasury testified. One of the graduates of the street, Mr. Gould, stated that he's a graduate but, you know, those graduates, they always go back for post-graduate work when they leave the Administration.

So, anyway, in his opinion, it has to be 15. Couldn't go with five. Now, of course, on the Senate side, they're talking \$7.5 billion, with

a revisitation.

Is it just that the price would be higher, as far as the interest rate that would have to be paid, if we go to 5 billion for 2 years, or \$7.5 billion with a revisitation to the Senate, as opposed to the 15 billion? Or are there other factors that you think should be considered by this committee when reaching a decision as to how much we approve and when and for how long a period of time?

Mr. Corzine. I think that the revisitation issue brings into question the basic principle that investors will look at both the economic viability and the commitment of the political process to the FSLIC recapitalization.

And I think that with a revisitation principle, they are going to be more uncertain and they are going to ask for a higher rate of interest with respect to whatever instrument you create, whether

it's zeros or whether it would be debentures.

I also think that zero coupon bonds will have a higher interest rate in the maturity spectrum that is talked about in a \$5 billion program than would be the case on straight debentures, just because the risk of knowing how the principle is going to be paid on those zero coupon bonds is not—I don't think sufficiently or certainly not as certainly defined as would be the case in the debentures.

So if you pick a number, 15 years paper would be somewhere in the eight and a quarter rate on a debenture, it might be in a 20-year piece of paper a zero B in the neighborhood of 10 percent. Some of that is an issue of zero coupon market, the nature of the instrument itself; and some of that differential in rate, between the two rates, would also be a function of uncertainty on how that principal would be paid off at the maturity.

So there are two elements there. I think, clearly, there are greater uncertainties associated with the \$5 billion program and then a revisitation in two or three traunches. And I think that might be

more difficult to sell. That would be my perception.

Chairman ST GERMAIN. Could it be sold?

Mr. Corzine. Yes, it can be sold.

Chairman ST GERMAIN. But you'd have to put a lot more sugar on it.

Mr. Corzine. It will cost more.

Chairman St Germain. OK. Ms. Kaptur?

Mr. Wylie?

Mr. Wylle. Thank you, Mr. Chairman. I'm sorry I wasn't here for all the testimony. If this question's been asked, you can say so

and I'll look at the record.

Mr. Wolf, on page 10 of your testimony, and you have done a considerable amount of work here and you've gotten a lot of publicity in the last few days over your findings, you say that the FSLIC insurance fund has steadily declined during the last 5 years, from \$6.3 billion in 1980 to a deficit position in 1986, and that FSLIC will have a deficit of over \$3 billion as of the end of 1986. That's your finding?

Mr. Wolf. Yes, sir.

Mr. WYLIE. FSLIC is insolvent and that's the implication of that statement, isn't it?

Mr. Wolf. That's correct. Their liabilities are greater than their assets.

Mr. Wylie. How can the Federal Home Loan Banks continue to make FSLIC-guaranteed advances, or loans to troubled institutions? Tell me the mechanism by which they do that.

Mr. Wolf. I'm not sure I can tell you the technical mechanism that they can do it, but if they do not have equity, if they are in a deficit position, it precludes them from doing some of those things.

Mr. Wylle. The Federal Home Loan Banks are in a fiduciary capacity and they have some responsibility to the shareholders when they make those advances. Right?

Mr. Wolf. The Home Loan Banks, I'm not sure that I follow

your question. Could you ask it again?

Mr. Wylle. Don't the Federal Home Loan Banks have a fiduciary responsibility to their shareholders?

Mr. Wolf. Yes, they do.

Mr. Wylie. So, when they make those advances, isn't there some question about whether that's a prudent investment?

Mr. Wolf. I think, as the fund has declined, people can begin to

raise those questions, yes.

Mr. Wylle. With respect to recapitalization, I think you've testified that the Treasury-Federal Home Loan Bank Board plan is the one you favor. Is that correct?

Mr. Wolf. Generally, yes.

Mr. Wylle. Generally.

Mr. Wolf. With a couple of provisos, but, yes.

Mr. Wylie. Have you said anything about the Proxmire plan?

Mr. Wolf. We have not talked about that specifically and we have not given any response to anybody in an evaluation of the plan.

Mr. Wylle. I heard Mr. Parris ask about it.

Mr. Wolf. It was sort of indirectly. Nobody specifically referred to that one.

Mr. Wylie. Would you comment on it, please?

Mr. Wolf. We have not done an indepth review of it, so what I'm saying is more of a general reaction. And, that is, if you limit the amount to I believe it's 7.5 in that bill, if you limit it strictly to that, then you have a potential problem in that we don't think that's enough to carry out the full program.

You then raise the question of confidence, and that's one of the things that the FSLIC is in effect there to do, is to provide the confidence to depositors that should a problem arise, they can deal

with it.

So I think that's the tradeoff you're making when you decide to go less than, in effect, the full plan, or however you want to characterize it.

Mr. Wylle. And that's generally your position, that some shortterm plan whereby the program would have to be revisited would not gain the confidence that's needed?

Mr. Wolf. Yes, sir.

Mr. Wylie. OK.

Mr. Wolf. I would draw a distinction though between good, strong congressional oversight and completely revisiting the issue. Whether we're going to do anything, there can be some distinctions drawn.

Mr. Wylle. What if we did nothing?

Mr. Wolf. If you did nothing?

Mr. Wylie. Yes. Mr. Wolf. You mean, you passed no—

Mr. Wylie. Yes, what if we didn't pass a recapitalization plan at all?

Mr. Wolf. I think that that carries some fairly distinct risks of loss of confidence in the marketplace.

Mr. WYLIE. What do you think, Mr. Corzine?

Mr. Corzine. I think that, as you have already seen take place in the spreads of the Federal Home Loan Bank debentures relative to other agency paper and relative to Treasury's in recent weeks, as the discussion of the problem of FSLIC has been dimensioned, they will widen and there will be an increasing—there will be increasing difficulty over time for the Federal Home Loan Bank to both turn over its debt and to raise additional capital. Similar kind of problem that's happened to the Farm Credit Bank.

Mr. Wylie. Does anyone on the panel have a contrary view?

[No response.]

Mr. Wylie. Thank you, Mr. Chairman. Chairman St Germain. Mr. Carper.

Mr. CARPER. Thank you, Mr. Chairman.

Our friend from Goldman, Sachs, do you pronounce your name Corzine?

Mr. Corzine. Yes, sir.

Mr. Carper. Mr. Corzine, let me just follow up on the chairman's earlier questions regarding the pricing or the difficulty of selling an issue that is more along the lines of the Senate proposal, or the

proposal that's before the Senate.

We had the opportunity about a month ago to meet informally, not in a formal hearing, but informally with some folks from the street and we talked about similar kinds of questions. And my recollection is that they tried to quantify the difference in price between a short-term—like what I call the bandaide approach, as opposed to the Treasury's more comprehensive approach.

I think they told us the price differential would be about 100 basis points more expensive for the smaller issue, the shorter term

approach.

Is that in the neighborhood? I realize you don't have a crystal ball to forecast these kinds of things. But is that in the ball park?

Mr. Corzine. Congressman, I was at that hearing. I think that's where I was coming with when I said that I thought you would be able to finance on the debentures and the Treasury Home Loan Bank programs somewhere in the neighborhood of eight and a quarter and under the zero coupon approach issuance of zero coupons, you would be in the 9.5 to 10 percent level on zero coupons.

And that's where you got that 100 basis points at that point. Now, the Senate proposal, which I am less familiar with in detail but I think it's essentially a having of the program, I think will cost marginal amounts on that 8 to 8¼ and a quarter. I mean, that

is not a 100 basis points differential.

It will be some differential to that. But I don't think anywhere near as significant as it would be with going with a zero coupon program as opposed to a debenture program, as in Home Loan Treasury proposal.

Does that address your question?

Mr. CARPER. Yes.

Mr. Corzine. I think it may be 25 basis points. These things are difficult for me to precisely assess.

Mr. CARPER. Okay. If you were giving me some advice on how to restructure the proposal that's inherent in the legislation before us, how would, again, how would you suggest that we restructure it—in order to maximize your ability and that of your peers to market this kind of issue?

Mr. Corzine. As I have tried to indicate, I think trying to dimension the need as precisely as you can will give you the greatest cer-

tainty of developing a program that meets that need.

Therefore, I would go with a larger program that has a longer time horizon to it than I would one that—and that again does not also distinguish that or preclude that you have good, strong congressional oversight in the process. I certainly am not arguing that.

But I do think that you need a program that the investor will be able to perceive will exist. It will continue in its format and it

won't be regularly restructured.

I think that leads to very serious cost over a period of time in the marketplace for the debt. And so I'm not talking about restructuring as much as I would certainly recommend to you that you dimension the program in your best judgment and have it in the longest possible time frame, good, strong Congressional oversight in the interim as the means as opposed to divying it up into several different congressional periods.

Mr. CARPER. Do any members of the panel have a contrary opin-

ion that you'd like to share with us?

[No response.]

Mr. CARPER. Okay. Again, thank you all. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Wolf, GAO has been quoted very widely saying FSLIC is insolvent, billions in the red. Now, is the fund actually insolvent? And is this perhaps caused by what you call FSLIC's contingent liability?

Mr. Wolf. I don't much like the word "contingent liability" because it sort of implies that maybe yes, maybe no. As I mentioned earlier, the way that we calculated that was to look at the worst of

the problem cases.

And, generally, using FSLIC's numbers, came up with about \$8 billion to deal with those absolute worst ones, the kind we talked about today, the A and B on that example, those types of things.

So, in that respect, we believe that's a liability and, yes, that is

part of what causes the deficit in their operations.

Chairman ST GERMAIN. And, therefore, you say they're insolvent?

Mr. Wolf. Yes, sir.

Chairman ST GERMAIN. And how much of that projected cost

would have to recognized immediately by FSLIC?

Mr. Wolf. We feel that all of that should be recognized now because that is a cost that they have already incurred for those institutions. They just haven't paid it.

Chairman ST GERMAIN. OK. Now the \$8 billion estimate reflects a total value of estimated FSLIC resolution costs for the entire pro-

jected case load—am I correct there?

Mr. WOLF. For only the worst of the worst. Chairman St GERMAIN. Only the worst.

Mr. Wolf. Yes.

Chairman ST GERMAIN. And is that why you distinguished between the contingent loss reserves and FSLIC's primary reserves?

Mr. Wolf. Well, that's where we draw the distinction between what is a liability—those that we know are going to go—and then the equity or, in this case, deficit of an institution which is to cover the remaining in effect insurance program.

Chairman ST GERMAIN. Mr. Bartlett. Mr. Bartlett. Thank you, Mr. Chairman.

Ms. Payne, when you're negotiating either with the borrower or to sell property, particularly with the borrower, are you permitted and indeed encouraged by the legislation to consider the global impact of your negotiations, or are you required to only consider the implications just to that one institution that holds the loan?

That is to say, if taking one course of action would have negative implications on other FSLIC-insured institutions, do you consider

that in the course of the negotiations?

Ms. PAYNE. The answer is yes.

Mr. Bartlett. And is that an ever present part? Are you satisfied you have adequate communications within FADA to make cer-

tain that all of those implications are understood?

Ms. PAYNE. Since we've really started to operate, which is since July of 1986, we have found that, in many cases, the communications throughout the whole FHL bank system were in fact not as strong as they should have been. We've brought that to the attention of the Bank Board and of the District Banks.

And, frankly, I'm delighted to report a tremendous improvement in that whole process of focusing on the topic in a broad way and the ability to communicate throughout the system. I'm very

pleased.

I would not have said this perhaps in July, but I certainly can say it now.

Mr. BARTLETT. Thank you.

Dr. Nowotny, you've had—I don't want to mischaracterize your testimony but from what's been said here today, you've had something less than a satisfactory negotiating relationship with FADA.

If you were in our shoes, is there something else that you would do? Is there some additional authority or change that you would provide the FADA or do you believe that it's just some sort of

growing pains? Or is it somewhere inbetween?

Mr. Nowotny. Well, I believe that some of it is growing pains, Congressman Bartlett. I also believe that one of the things that has caused us some frustration is when the institution we were dealing with initially came under supervision, we began to deal and felt that we were dealing on a resolution of that particular loan portfolio with the knowledge of the Federal Home Loan Bank.

When the circumstances changed on the institution side, it also—it essentially erased 4½ months worth of our business activity, thinking that we were near completion of an arrangement. We

actually had to start over.

And, in fact, the process has been slower in the startover than it was initially in dealing with the supervisory consultant. And I attribute that to, number one, the disruption, physical disruption which occurred with the files in the lender's home. And this was related to me by the FADA staff.

They could not physically assemble the files to study them; that's why we provided a complete set of our own. They have assumed a very large workload and my understanding is that various individuals within that staff may have as many as 50 different projects that they're responsible for.

And that's large by anybody's standards. I feel that in comparison to dealing with the supervisory consultant, which is my only other experience with that institution, the difference is that we sat

across the table early on and we said:

What are your concerns? What are my concerns? How can we

reach a positive resolution of this?

We have never had that exchange or the ability to have that exchange with FADA to date. We've tried. We've urged let's sit down and roll up our sleeves and work on this.

That's what I think the problem is. We cannot get the communication going to reach a resolution. It's been a holdback situation.

Mr. Bartlett. So if you were giving recommendations to Ms. Payne, not necessarily for your negotiation but generically, it would be to increase the direct communications as opposed to sending letters to one another?

Mr. Nowotny. Yes, sir. That doesn't get us too far.

Mr. BARTLETT. Thank you.

Ms. Payne, one other question. Your testimony I think was very, very clear and very helpful to the committee on the negative impact of applying the open meetings law and the precise legal terminology of characterizing FADA as a public/private partnership, and other things.

You've provided then to the committee some precise language where we could obtain the result that we want, and that is over-

sight of FADA without the negative result.

Ms. PAYNE. Correct.

Mr. BARTLETT. Does FADA also have a conflict of interest statute

for your own employees?

Ms. PAYNE. We have a very detailed conflict of interest policy, both for our employees as well as for our directors. And if you would like, I would submit that here for the record.

Mr. Bartlett. With the permission of the chairman, I'd ask unanimous consent that that be included as part of the record.

Chairman ST GERMAIN. Well, now wait just a second. How detailed and how-

Ms. PAYNE. It's several pages in length.

Chairman St Germain. Not 50 or 60 pages?

Ms. PAYNE. No, sir, far less than that.

Chairman St Germain. Well, roughly?

Ms. PAYNE. Oh, I'd say seven or eight. Chairman St GERMAIN. All right. We've got to watch this Gramm-Rudman stuff. I mean, I have to go up before the House Administration and get money. [Laughter.]

Mr. Bartlett. If their conflict of interest prohibitions or restrictions were so detailed as to be 50 pages, well, then, it might be that

we ought to look at it. [Laughter.]

Chairman ST GERMAIN. Without objection.

The referred to FADA conflict of interest policy submitted by Mr. Payne can be found in the appendix.]

Mr. Bartlett. I thank the chairman, and I thank the witnesses. Chairman St Germain. Let me ask you, do FADA employees have indemnity insurance?

Ms. PAYNE. The boards of directors do and I, as a member of that

board, have such an indemnification.

Chairman St Germain. Who pays those premiums?

Ms. Payne. The savings and loan industry pays the premiums into FSLIC, both by the regular assessment and the special assessment.

Chairman St Germain. And how about the rest of the employees

at FADA, other than the board members and yourself?

Ms. PAYNE. We have an internal indemnification by virtue of the savings and loan regulations, but it's only pursuant to savings and loan regulations.

Chairman St GERMAIN. Thank you.

If there'll be no other questions, we will thank the panel. We have some additional questions to submit in writing, we would ask your cooperation.

We thank you for your cooperation today and your patience with

us, but we did want to get this hearing completed today.

We have a panel of witnesses tomorrow that we'll be hearing from. We will meet at 10:30 tomorrow morning, and the subcommittee will be in recess until that time. And, again, thank you, ladies and gentlemen.

Whereupon, at 3:55 p.m., the subcommittee adjourned, to recon-

vene at 10:30 a.m., Wednesday, March 4, 1987.]

APPENDIX

STATEMENT OF CONGRESSMAN DOUG BARNARD, JR. AT FSLIC RECAP HEARING - MARCH 3, 1987

Mr. Chairman. I want to make a brief comment about the testimony we will hear today on appraisal standards and the role of appraisals in establishing market values for troubled real estate assets collateralizing thrift loans and investments.

Last week, I sent each member of this Subcommittee a copy of a report issued by the House Commerce, Consumer, and Monetary Affairs Subcommittee entitled, "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market". This report documented the pervasiveness of appraisal abuses and the way in which fraudulent and faulty appraisals facilitate unsafe and unsound real estate loans and investments — often as a result of pressure from borrowers, developers and the lenders themselves. The report concluded that abusive appraisal practices have played a major part in the failures of many thrifts across the country and a loss to the deposit insurance fund of at least one billion dollars.

Therefore, approval of FSLIC Recap legislation must be accompanied by assurances that the appraisal process will be insulated from pressures to produce whatever numbers are necessary "to make the deal"; and that the federal banking agencies will aggressively enforce this imperative through the supervisory process. In the event of a default on a real estate loan or investment, the only thing that stands between the lender or investor and a loss, is the market value of the collateral, as established by the appraiser. If forbearance is an appropriate regulatory tool to keep open thrift institutions that, through no fault of their own, are facing difficult times —and a strong case can be made that it is — tinkering with the appraisal process is not the correct way to implement this policy. At a time when we are trying to move away from regulatory accounting principles, the use of "funny" appraisals in the loan files should be discouraged.

Since the issuance of our report, substantial progress has been made at the federal level and in the private sector to correct appraisal abuses and their damaging effects.

The federal banking agencies together with the FHA, VA, Fannie Mae and Freddie Mac, have established an interagency task force to coordinate appraisal policies and to tighten supervisory practices. In the private sector, the leading appraisal groups, such as the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers, have acknowledged their industry's problems and are working with me toward the introduction of legislation creating an appraisal industry Self-Regulatory Organization. I also want to compliment the Federal Home Loan Bank Board for dealing with a few serious problems in connection with its R41(c) appraisal standards.

STATEMENT OF L. L. BOWMAN III
TEXAS SAVINGS AND LOAN COMMISSIONER
BEFORE THE SUB-COMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
U. S. HOUSE OF REPRESENTATIVES, MARCH 3, 1987

I want to thank you, Chairman St. Germain and Members of the Sub-committee, for allowing me the opportunity to comment on H.R. 27, Chairman St. Germain's bill entitled the "Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987", and on H.R. 1063, introduced by Mr. Bartlett, with three co-sponsors, entitled the "Thrift Forbearance and Supervisory Reform Act".

My comments in regard to H.R. 27 will be general, and then I will have more specific comments in regard to H.R. 1063.

I am in full support of efforts to recapitalize the insurance fund administered by FSLIC. The form of recapitalization and the amount of recapitalization is certainly important, but I do not view it as my role as a state regulator to try to influence those issues. Obviously, FSLIC must be recapitalized in the very near future if the extensive problems facing the savings and loan industry nationwide are to be dealt with effectively. Ιt seem's to me that the general approach of H.R. 27 in using the resources available through the Federal Home Loan Bank system is a logical and worthwhile course, and I view the billion capitalization of the Financing target of \$3 Corporation to be a worthwhile minimum amount for this effort.

I will not address the specifics of the structure of the Financing Corporation or its relation to the Federal Home Loan Banks and FSLIC, as those matters do not directly affect my role as a state regulator. I do wish to reemphasize that a recapitalization of the FSLIC fund immediately is essential if state and federal regulators are to deal with the number and size of problem institutions in our industry today.

One specific concern I would like to express in regard to H.R. 27 is with respect to Section 7, which apparently makes the Federal Asset Disposition Association subject to certain audit, reporting, and open meeting requirements under federal law. I am certainly not an expert on such matters, but my concern is that such provisions might operate to seriously hamper the effectiveness of FADA in dealing in a businesslike fashion with the extensive real estate holdings which it now has or is likely to have in the future. Making FADA's operations and records subject to public disclosure would, it seems to me, tend to undermine their ability to effectively negotiate the best business result with regard to secific assets.

In regard to Mr. Bartlett's bill, H.R. 1063, I am in favor of the four forebearance measures obtained in Section 2 of the bill. It seems to me that amortization of loan losses, the use of generally accepted accounting principles in accounting for problems loans and restructured loans, and the use of general reserve accounts which are not charged against the association's net worth, are reasonable and worthwhile approaches to certain problems facing our

industry, especially in Texas and some other states. As you may know, the forebearance provisions of Mr. Bartlett's bill genrally parallel those measures recommended by the subcommittee on regional problems of the United States League of Savings Institutions Task Force on FSLIC issues, which was chaired by Mr. McCallister, also appearing on this panel today. I served on that sub-committee, and I support its recommendations, which Mr. Bartlett's bill seeks to implement.

I also agree that those loan losses or perspective loan losses which are the result of misconduct by an institution Or its management should not be subject to amortization, as in some instances, we find that the Association or its management has, in essence "given away" money in a bad loan which results in the loss. Clearly, such misconduct should rnot be condoned through an extended amortization process. Further, it is not clear to me that this exclusion from forbearance for such loan losses also would apply to the Other provisions of the bill in regard to accounting and reserves for such loans. It is my understanding that the purpose of the bill is to allow some forebearance on loans which are problems through no fault of the institution or its management, and it is my reading of the bill that the provisions disallowing forbearance for those loan losses as a result of management misconduct only applies to the amortization provision of the bill. I think consideration should be given to applying that standard to the other forebearance measures as well.

I would further suggest that the extended amortization by allowed to an institution located outside the economically depressed region for all loans to borrowers or secured by property in the economically depressed region. As I understand the bill, it would require the institution to have a <u>substantial</u> portion of its portfolio in such loans to qualify for extended amortization. It would seem more equitable to me to allow the forbearance, based on the location of the loan, and not require a percentage test of the portfolio for the institution to qualify.

In regard to Section 3 of the bill, entitled "Improvements in the Supervisory Process", the review provision seems reasonable, as I have long been concerned about the apparent lack of an appeal remedy for an institution under the classification of assets rule. While it may not be necessary to deal with the issue of timeliness of the review in the statute, I believe that issue needs to be addressed either in the statute or the regulation, to insure that the appeal process can be accomplished in a reasonable period of time.

I also support the provision of the bill which allows flexibility in classifying loans and analyzing financial capability of borrowers, as well as waiver of approval requirements. I strongly favor the provision for allowing flexibility in requiring reappraisals of property which is acquired through foreclosure. I do not intend to require institutions under my jurisdiction to reappraise every peice of foreclosed real estate under state regulations. It seems

to me that, under current economic conditions, such reappraisals are suspect, and are causing undue financial and regulatory burdens to the institutions we regulate.

I am also in support of the provisions in regard to removing FSLIC from budgetary and personnel constraints. I believe FSLIC needs the ability to recruit top-quality personnel, especially at the executive director and senior staff levels, with the expertise needed to administer new funds properly. There has been extensive turnover in the senior staff levels in the past three years at FSLIC. The agency needs the flexibility and independence to attract high quality staff, and the provisions in Mr. Bartlett's bill to accomplish this are necessary.

Finally, I strongly favor the provisions in Section 5 in Mr. Bartlett's bill in regard to studying the feasability of establishing an Asset Acquisition Corporation. A similar idea, to establish an asset management corporation to manage troubled real estate and recommend alternatives for institutions, discussed a year ago in Texas, and a plan was devised to establish such a corporation in Texas. However, the persons willing to participate in directing and managing such a corporation were industry lenders who felt they would need idemnification from FSLIC for any claims which might arise from institutions participating in real estate transactions with the corporation, and the plan never came to fruition due to an apparent reluctance on the part of FSLIC to indemnify such persons. Thus, the seeds of the idea have been planted, and the concept should be pursued.

Mr. Chairman, my only comment in response to your letter's request about change of control matters is that I perceive no serious problems in the way the state and federal approval processes function.

Finally, Mr. Chairman and Members, I wish to advise you that, contrary to certain impressions which have been created by recent media converage of certain savings and loan events in Texas, I and my Department staff enjoy good working relations with Mr. Green and the Federal Home Loan Bank of Dallas and the Federal Home Loan Bank Board here in Washington. No one should infer, from the fact that there may be occasional disagreements on how to handle particular situation or the timing of certain actions, that the state and federal regulatory authorities are not intend to continue a good working cooperating. I relationship with our federal counterparts. I believe we all share the common objective of trying to weed out certain problems in Texas, deal with the real estate problems at hand, and seek to support a safe and sound savings and loan industry in Texas and the United States. We face some very very difficult problems in the two to three years ahead. look forward to a working relationship with Mr. Green and the Tederal Home Loan Bank of Dallas which is good, and getting better, in dealing with these problems. Thank you for your time and attention.

House Committee on Banking, Finance and Urban Affairs Subcommittee on Financial Institutions Supervision, Regulation and Insurance

> FSLIC Recapitalization Héaring March 3, 1987

Statement By:

Roy G. Green, President and Principal Supervisory Agent

H. Joe Selby, Executive Vice President and Director, Regulatory Affairs FHLB of Dallas Dallas, Texas

10:00 a.m. 2128 Rayburn House Office Building

INTRODUCTION

Thank you for the opportunity to testify today on the process of regulation in the Ninth District of the Federal Home Loan Bank System and on the recapitalization of the Federal Savings and Loan Insurance Corporation, the issue of forbearance and the long-term stability and viability of the thrift industry.

Our statement, which follows, will essentially show that there is much to support the widely-held perception that a poor and deteriorating economy is the basic problem with a majority of thrift institutions in the Ninth District. However, there is much more which has been added to that scenario to provide a complete picture for the committee.

Specifically, it points out that there is a relatively small but significant number of institutions in our District which took every advantage of the deregulatory environment. This group was characterized by excessive growth into very high risk and speculative assets funded by high cost and volatile liabilities. The management in these institutions generally had poor to nonexistent underwriting practices, inadequate disbursement controls and serious shortcomings in their recordkeeping. Characteristically these high risk institutions have failed at a

record rate and are primarily responsible for imposing extremely high and escalating costs to FSLIC and to the industry in general. It is essential that this group be separated and dealt with differently than those institutions that have actually been disadvantaged by the economy. That is, in fact, the approach that is being followed by the Federal Home Loan Bank of Dallas.

Today we will first review briefly the recent history and perceptions of the situation in the Ninth District, and then discuss the essential facts and figures relating to the economy and the supervisory environment for federally insured savings institutions. Following that, we will highlight three specific cases that have been presented to the Federal Home Loan Bank of Dallas for appropriate action. Finally we will share with you actions that have been taken to address the overall situation, as well as to recommend approaches that, we believe, will help the industry, the regulators and, most importantly, the public we all serve.

BACKGROUND

The situation that we face in the Ninth District is essentially the result of two distinct events. First, the deregulation of the thrift industry (and the financial services industry) in the early 1980's and, second, a deteriorating economic environment in the southwest that has occurred primarily in the last 18 months.

Deregulation of the industry beginning with the liability side of the balance sheet in 1980 and followed with the asset side of the balance sheet in 1982, set the stage. Both the 1980 and 1982 legislation were necessary landmark initiatives which have provided us with both benefits and challenges. The legislation deregulating portfolios in order to combat interest rate spread problems also placed new responsibilities on the thrift industry and the regulators. We believe the industry and the regulators have in large measure responded promptly and appropriately. However, the new deregulated environment was vulnerable to abuse by some individuals. The excessive growth that these so-called entrepreneurs directed FSLIC-insured institutions to pursue for quick profits has resulted in asset portfolios that fall far short of industry standards for long-term value and sound underwriting.

Problems caused by these individuals were exacerbated by economic events in the early 1980s: double-digit inflation and up-to-20 percent interest rates. The thrift industry's commitment to housing Americans through long-term financing supported by short-term deposits quickly resulted in a negative spread for a large number of thrift institutions. We would also remind you that this commitment was mandated by both Congress and the industry's regulators, in order to achieve important public policy objectives.

This funding of long-term assets with short-term deposits

resulted in severe earnings problems that weakened the industry as it approached the deregulated environment. Yet this environment simultaneously made it attractive for thrift institutions to find new avenues for lending and investments, and tremendous competitive and financial pressures to expand in an attempt to grow out of the problems. Many institutions moved too rapidly into non-traditional lending as they sought to bolster earnings to enhance capital positions that had been decimated as a result of the severe operating strains of 1980 through 1982.

In the Ninth District that strategy of extraordinary growth was very easy to pursue, for the economy was booming in Texas and throughout the Sun Belt. In the southwest, and in Texas particularly, significant inmigration was the norm, development in nearly all economic sectors was occurring at a rapid pace, and cities and counties were encouraging enormous growth through their zoning policies and building permits.

Money from all over the nation came into Texas to fund the growth. Many otherwise cautious businesses failed to take into account that all segments of the economy are cyclical; many pursued activities in our regional area as if there could be no downturn.

It is from a very high point of economic activity -- some would say an unnaturally high point -- that we have had to face the current downturn in the economy in the southwest. Major

adjustments in the energy sector as a result of domestic and international activities, as well as substantial changes in the agricultural sector, have had both direct and indirect effects on the thrift industry and the people and the communities that the industry serves. Unfortunately, the environment was so attractive that some less-principled entrepreneurs came in as well: funds were diverted, in some cases into their own pockets, and a disaster was left in their wake.

One among many suggested solutions to the situation is to simply provide time for the economy to recover. The perception is that where reasonable-at-the-time business decisions were pursued and the values of property have recently declined, those values will in time recover and profits will recover as well. This view has translated into the recommendation for forbearances on the recognition of actual losses and for the easing of supervisory efforts.

In this context, firm regulation is sometimes portrayed as a barrier to resolving the problem rather than a necessary component of both the recovery and preservation of the industry.

These are some of the perceptions that have been shared with us as to what has led to the current situation in the Ninth District and how we should approach our responsibilities based on those perceptions. There is, however, more that can be learned by reviewing some of the facts of the situation in the Ninth

District, from economic and financial perspectives, and by considering the industry on more than an aggregate or broad basis. There are several segments operating within the thrift industry in the Ninth District and these individually have had a dramatic impact both on the aggregate statistics as well as, we believe, the proper and most effective methods for approaching a very complex situation.

It is certainly accurate that the current economy of the Ninth District is poor. In an area that is commonly referred to as the "oil patch", the energy industry is in particularly dire straits. Oil prices continue at low levels and recent newspaper articles about unsettled OPEC conditions give little prospect for improvement in the near future. At the same time, agriculture, another important aspect of the economy in the Ninth District, has also suffered from a mismatch between the cost of production and the price received for commodities. With these conditions, unemployment in the District has climbed and now exceeds the national average by a substantial percentage. And the real estate market, both commercial and residential, has been drastically impacted with values down over 30 percent in some areas. Of course these conditions have dramatically impacted the financial services industry in the Southwest, including both commercial banks and thrift institutions. While there are differing opinions as to whether the economy in this area has in fact "bottomed out," there is widespread acknowledgment that the recovery period is likely to be long, with most estimates in the

four to five year range.

with their close ties to the real estate industry, a majority of thrift institutions in the District have been adversely affected by these economic conditions. A quick review of key financial figures for the District amply supports that point. In 1986, regulatory net worth declined 51 percent; loan delinquencies increased \$8.3 billion; and the overall return on assets declined 260 basis points. However, it is essential to examine the situation more closely; there is a relatively small number of institutions within the District that have exploited and abused the opportunities afforded by deregulation and these few have skewed dramatically the performance ratios of the industry as a whole. These institutions are, necessarily, the primary focus of our regulatory efforts and should be the focus of considerations of the pending FSLIC recapitalization legislation.

A recently completed study conducted by the Dallas Bank segregated institutions in the Ninth District into four distinct categories. In this study, 58 percent of the institutions in the District were determined to be well managed and profitable, 21 percent of the institutions were considered to be well managed but experiencing problems related to the economy, and 12 percent of the District's institutions were considered to be troubled but with strong prospects of eventual recovery. Nine percent, including many of the opportunists mentioned, are considered to be non-viable. A major portion of this segment includes

institutions already in the Management Consignment Program or under other supervisory control.

Addressed in another way, if the non-viable institutions in that study were eliminated from the District's statistics, the District numbers would show substantial improvements. For example, regulatory net worth as a percent of total assets would be increased from 1.6 percent to 4.7 percent. Loans delinquent more than 60 days would decline by over \$5 billion. And the overall return on assets of District institutions would increase 162 basis points.

From yet another perspective, it is our belief that if the uncertainties associated with this group of institutions could be removed from the funding situation in the Southwest and the cost of deposits for our institutions declined to the national average, profits for thrift institutions in Texas alone would be increased by an estimated one-half billion dollars annually.

The severely troubled institutions are the focus of our supervisory work at the present time. Over the past two and one-half years since the current principal supervisory agent has been managing the regulatory affairs of the Federal Home Loan Bank of Dallas, significant amount of effort of the Dallas Bank has been directed to the identification and containment of problem situations. With substantial additions to staff and a current examination schedule, this goal has been largely

attained. The focus of our supervisory efforts now is shifting to retainment of viable institutions and the continuation of a strong and prospering thrift industry in the Ninth District.

The following case studies are presented without specific names and references. The first two cases serve to illustrate the severely troubled institutions in the Ninth District whose condition is a primary result, not of the economy, but of poor and imprudent management practices. The third shows what can be accomplished in working with those less troubled, well-managed institutions that have suffered losses largely from economic conditions.

"ASSOCIATION A"

During 1982, 100 percent of this institution's stock was acquired by a single investor. Subsequently, the institution followed a course of rapid growth, from \$29 million to \$2 billion in assets, or a 1475 percent increase on an annualized basis, funded to a large extent by brokered and jumbo certificates of deposit. This thrift shifted from a traditional 1-4 family loan originator (92 percent of portfolio) to an institution heavily involved in acquisition, development and construction (ADC), commercial and industrial, and over-five-family dwelling unit loans (83 percent of portfolio). Prior to acquisition, examinations revealed that Association A was free of substantive problems. Subsequent examinations, however, revealed unsafe and unsound practices and

regulatory violations which were of such a magnitude that the institution's viability was jeopardized.

To halt the serious and continuing regulatory violations and unsafe and unsound lending practices, a temporary Cease and Desist Order was issued. Following the issuance of a permanent Order, an examination was commenced which revealed severe asset quality problems and continuation of loan underwriting deficiencies, violations of law and regulations and non-compliance with the provisions of the outstanding Cease and Desist Order. At the next examination and after continued deterioration in the association's financial condition, the examiners reported the thrift's insolvency. As a result of the poorly-managed rapid growth and substandard-quality asset portfolio, the institution failed and was placed into receivership in 1986.

The basis for this action were re-appraisals ordered by the Federal Home Loan Bank of Dallas. As a result of such re-appraisals, Association A which had been reporting a positive net worth exceeding \$50 million was estimated to have a negative net worth of more than \$56 million at receivership. Since that time, an independent consultant has reviewed the value and prospects for ultimate disposition of the assets. This, as well as an analysis performed by the managing institution, indicates that the losses are much greater than anticipated. In fact, as of December 31, 1986, the successor to Association A reported a

combined total of \$800 million in foreclosed and repossessed assets and loans 60 days or more delinquent, which represents 50 percent of total assets. Loan losses of \$350 million have been recognized and net worth has declined further to a negative \$400 million. The following is an example of the quality of the loan portfolio.

Association A made a \$65 million loan to a joint venture during late 1985 based on an appraised value of \$60 million as is, and \$85 million as developed. The loan wrapped a \$32 million loan made by another Texas thrift for the purpose of financing the acquisition of the property. In the two months before Association A made its loan, the property was sold six times, sometimes between inter-related parties, and its value increased from \$16.8 million to \$50 million. This increase in value was not supported by the appraisal report or other sources of market value information. Additionally, the loan had four guarantors; however, the contract states that no deficiency judgment shall be allowed against the borrowers, guarantors or principal partners of the borrower. As a result of the aforementioned deficiencies and the failure to obtain adequate financial information, the loan was classified doubtful during the examination and a 50 percent loss reserve was required.

As was often the case for this institution, the loan was granted for the purpose of acquiring and developing real estate with roadways and installing utilities on the basis of an eighth lien. The contract requires principal and interest payments on the underlying wrapped loans 15 days before they are due to the underlying lien holders. The balance of the loan disbursed by Association A only requires interest payments. All payments were due and remain unpaid since June 1986, and as such have resulted in the acceleration of the underlying mortgages and initiation of foreclosure proceedings. A Bank Board ordered re-appraisal estimated a value of \$21 million, and the independent consultant estimated a value of \$23 to \$26 million for the property. Under either valuation, it is estimated that liquidation proceeds will not cover the underlying wrapped loans and the result will be a 100 percent loss of Association A's disbursed funds. In addition, the consultant projects that the property would require an eight to ten year holding period for development and sale.

An independent third party evaluation recommends that Association A allow underlying lien holders to foreclose and that the institution write-off its loan.

The United Stated District Court for the Northern District of Texas recently upheld the Bank Board's appointment of The Federal Savings and Loan Insurance Corporation as receiver, noting that the administrative record amply supported the Bank Board's conclusions that Association A "was insolvent and had so dissipated assets as a result of violations of rules or regulations and unsafe or unsound condition as to be in an unsafe or unsound condition to transact business."

"ASSOCIATION B"

Also during 1982, an individual acquired 91 percent of the outstanding stock in Association B. Later that same year, the Federal Savings and Loan Insurance Corporation approved an application filed by a shell comparation to acquire control of Association B. The shell company was formed by the majority owner to facilitate this transaction. This company acquired these controlling shares and additional minority interests, and assumed the indebtedness of \$5.4 million connected with the purchase of stock. The holding company also contributed non-cash assets in exchange for the issuance of additional stock, which increased Association B's reported net worth by approximately \$10 million. The majority stockholder retained 72 percent of the holding company stock.

There were no outstanding items of supervisory concern when this institution was acquired. However, beginning with the acquisition, Association B began to aggressively expand its assets and departed from traditional lending activities. Assets increased from \$78 million as of December 31, 1981 to \$1.3 billion as of December 31, 1986, a growth of 1627 percent. The Association's growth was fueled by high cost brokered and jumbo certificates of deposit which were, in turn, used to fund highly

speculative acquisition, development and construction loans.

After the acquisition, the Association began a policy of financing for many selected borrowers all closing costs and fees, the purchase price of the land, and future interest costs.

Frequently, Association B financed all or nearly all of the two to five points charged on construction loans. Moreover, many transactions were entered into without regard to proper underwriting standards. Often, the Association did not conduct a financial analysis of the borrowers or relied upon outdated financial statements. Furthermore, Association B frequently granted loans without benefit of appraisals or upon faulty or deficient appraisals.

Association B also made several loans secured by the stock of other associations, several of which are now insolvent. In most instances, there was no evidence in the loan records to indicate that the institution performed an analysis of financial statements or verified the borrower's ability to repay the loan.

Post-acquisition examinations noted significant regulatory violations, unsafe and unsound practices, lending deficiencies, inadequate books and records, and frequent turnover in senior management. The lack of management or direction by the board contributed to operating losses, continued liability growth, substantial indicated losses and non-compliance with the provisions of a supervisory agreement with the Federal Savings

and Loan Insurance Corporation. The agreement was designed to provide the institution an opportunity to informally resolve the regulatory violations.

However, as a result of Association B's continuing disregard for regulatory compliance and the agreement, an Order to Cease and Desist was issued during 1986. In addition to lending restrictions, this Order required a business plan be provided for diversification of assets, that lending and investment policies be adopted, and that the institution maintain proper books and records in one location.

Association B also voluntarily entered into an agreement with the State of Texas which authorized the Commissioner to place an Agent on the association's premises.

As a result of losses in securities transactions, investments in subsidiaries, and lending operations, Association B's reported net worth significantly eroded from \$65 million as of December 31, 1985 to a negative \$350 million as of December 31, 1986.

This figure reflected \$67 million in operating losses for the six months ended December 31, 1986, valuation reserves of \$340 million established voluntarily by the Association and including \$6 million in reserves for losses on securities transactions which the Dallas Bank directed be established. With its acknowledged insolvency, Association B entered into a Consent Merger Agreement with the FSLIC late in 1986.

Beginning with the acquisition, management officials of Association B had the exclusive use of numerous expensive non-earning assets of the institution, including luxury automobiles, a hunting club, a yacht, five airplanes and pilots, and three beach houses. Such use of corporate assets clearly violated the spirit of conflict of interest regulations and can be construed as a misappropriation of corporate assets because there is no evidence of approval of these arrangements by the institution's board of directors. In addition, the Association paid compensation and dividends on the basis of inflated profits. Since the acquisition four years ago, the majority stockholder has directly received salary, bonuses, deferred compensation, and dividends totalling approximately \$8 million. As noted, a large part of Association B's "income" has been self-generated from the financing of fees from the proceeds of loans that are now delinquent. Clearly, the amount of dividends and bonuses were determined, in part, by the self-generated fees from ADC loans. As of December 31, 1986, approximately \$900 million, or 67 percent of assets were in delinquent or foreclosed loans.

In contrast, Case C is significantly different.

"ASSOCIATION C"

As in the two previous cases, an individual investor acquired

control of Association C in 1982. The following year this investor was instrumental in forming a holding company which acquired a 94 percent controlling interest in the institution. The investor retained a 60 percent interest in the holding company.

Since acquisition, Association C has grown from \$80 million to \$225 million as of December 31, 1986. During this same period, the institution invested in similar types of loans as our previous examples. However, its growth was manageable; traditional, less-risky mortgage loans constitute a much higher proportion of its assets, and its lending records are exemplary. In addition, independent review of its assets reveal that the collateral is far superior to that securing loans granted by the previous two institutions and is likely to recover value as the economy recovers.

The net worth of Association C grew steadily from just under \$3 million as of December 31, 1981 to over \$5 million, or three percent of assets, as of year end 1985. During 1986 net worth declined substantially to less than \$1 million, or .4 percent at year end. The decline is attributable to operating losses resulting from the high level of nonperforming assets. As of December 31, 1986, loans delinquent 60 days or more and foreclosed and repossessed assets aggregate \$60 million, or 27 percent of total assets.

The association's problems are attributable to economic downturns and not to the lack of underwriting standards, unsafe and unsound practices and self dealing seen in the other two cases. In recognition of their situation, management has not paid dividends since 1985.

Our regulatory response to Association C's problems has included various meetings with the directorate and controlling person which ultimately led to the execution of a supervisory agreement. This agreement required the Association to control liability growth, infuse capital, and obtain a business plan to address internal methods of improving operations. This office is continuing to work with this institution to achieve our common goal of returning Association C to viability.

It is not surprising to us that we receive negative feedback from institutions like Associations A and B. In contrast, the majority stockholder of Association C has written the following comments to this office: "As Chairman of [Association C, where we are having our own unique borrower and examination difficulties], I just want to tell you that [our supervisory agent] has been excellent; firm yes, but intimidating and rude no. There is a lot going for us here in this state as well as in our region, and with all of us pulling together in a spirit of cooperation and understanding, we will again lead our nation. Mr. Green, I want to say thanks for the fairness and the attention that we are receiving. I am hopeful that the coming year will

prove better for all of us."

These three cases represent some of the actions that have been taken by both non-viable and economically disadvantaged institutions in the Ninth District and our regulatory approaches to them. As you can see, in two of these case studies, the problems we encounter in non-viable institutions generally follow a pattern of gross mismanagement; in many cases there is self-dealing and, in some cases, fraud. Without exception, such situations are very costly for FSLIC to resolve. Unfortunately, we have a number of cases such as these to address.

Cases such as those highlighted here as Associations A and B are, regrettably, not unique, although they do represent a small segment of the industry. Neither is Association C unique; fortunately, there are a larger proportionate number of cases like Association C that we do believe will return to viability as capable and prudent management works through their problems with our help. It is our approach to work cooperatively with those with good management and to address firmly the problems created by imprudent and incompetent management.

ACTIONS

There have been a number of actions taken by the Dallas Bank to ensure that well managed institutions suffering from economic

problems are given every opportunity to work through their difficulties and at the same time address that relatively small number of institutions with overwhelming problems that are threatening the viability of the industry.

Substantial practical forbearances have already been provided. For example, fully 44 percent of the institutions in the Ninth District are operating with regulatory capital below minimum requirements. This includes 74 institutions that are reporting negative regulatory capital and continuing to operate. This percentage is highest among the twelve Federal Home Loan Bank districts and also shows much more tolerance for such situations than is evident with the commercial bank regulatory agencies.

Where we have the authority, we have also taken many steps to move away from a strict adherence to regulations and to initiate a safety and soundness philosophy in our supervisory work in the Ninth District. This has resulted in many initiatives, including: the creation and use of an informal commitment letter in lieu of more stringent supervisory agreements; where appropriate, requiring specific reserves on doubtful classifications at the minimum allowed within the asset classification regulation; a reduction in the reliance upon appraisals throughout our examinations and supervisory work; and a recently initiated review of outstanding administrative action to eliminate unneeded reporting and approval requirements in those cases where we have confidence in the capabilities of

present management. With regard to the asset classification regulation, we have been working closely with the Federal Home Loan Bank Board in Washington to initiate some appropriate changes in the regulation. Many of these changes were announced by the Board last Thursday. Finally, we have established a comprehensive review process within the Dallas Bank, one step of which includes members of senior management acting as a Regulatory Review Committee, to ensure that our applications of the asset classification process, as well as other regulatory decisions, are both fair and consistent.

Changes have also been made in the Regulatory Affairs Division of the Bank. In addition to merging the supervisory and examination departments into one overall operations department to improve timeliness and response to our members, we have also incorporated changes directed at accommodating ongoing additions to staff, strengthening our regulatory processes, providing needed technical training, increasing our use of technology — especially in the area of examinations, and most importantly improving our overall communications with the industry. Our emphasis on communications has included a new bulletin system for sharing information with our members, seminars on significant areas such as asset evaluation and capital and, most recently, general meetings with senior managers of our member institutions.

Actions have also been taken by the Federal Home Loan Bank Board in Washington. In a comprehensive policy statement issued last

Classification regulation directed at increasing the flexibility of supervisory and examining personnel and making our regulatory approach more similar to the approach used by the bank regulatory agencies. Also announced were clarifications to the appraisal guidelines in R-41c. Such clarifications are designed to reduce costs to the industry, and at the same time maintain the high standards embodied in the present memorandum. The Board also reiterated its position on support for troubled debt restructuring and forbearance with regard to insolvent insured institutions. Most importantly, a formal capital forbearance policy for well managed institutions that have been affected by economic problems was announced. These actions are fully supported and, where needed, are being implemented immediately by the Dallas Bank.

Recently introduced legislation entitled The Thrift Forbearance and Supervisory Reform Act (the Act) seeks to provide forbearances to institutions located in economically depressed areas of the country. We fully endorse measures which provide for flexibility in dealing with the problems facing institutions located in such areas. In fact, where discretion is provided by current regulation, we at the Dallas Bank have exercised it. Additionally, the Bank Board's implementation of a formal and uniform capital forbearance policy is consistent with the philosophy underlying the Act.

We endorse many of the concepts, including the use of GAAP accounting and FASB-15, embodied in the Act. We are also in favor of the Bank Board undertaking a study of the creation of an asset acquisition corporation to warehouse real estate assets and legislation which would increase the autonomy of the Federal Savings and Loan Insurance Corporation. We applaud Congressman Barlett's recognition of the need for limits to be placed on commercial lending and for collateral requirements on development loans, particularly the requirement the borrower have equity in the project.

There are, however, provisions of the legislation about which we have concerns. Specifically, we do not endorse the proposed amortization of loan losses over a five to ten year period principally because such an approach is inconsistent with the principles of GAAP and we strongly favor the thrift industry moving to GAAP as soon as possible. Such measures could reverse progress being made to improve confidence in the thrift industry's accounting practices and eventually lead to a loss of confidence in the credibility of the financial statements of thrift institutions. Such a situation could be an impediment to the critically needed influx of capital to the thrift industry. Reserve accounts which are established in consideration of the quality of the asset portfolio and included as a part of net worth are more appropriate than deferring losses and, in fact, provide a clearer picture for investors and the public about the actual condition of an institution. Additionally, in our

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Opinion, the ongoing implementation of a uniform capital Eorbearance policy negates the need to provide forbearances from Ecognizing loan losses.

The Act also embodies the concept of an appeals process for supervisory decisions. We support such a concept and, in fact, at the Dallas Bank, regulatory judgments and decisions are subject to multiple reviews, including a Regulatory Review Committee, to ensure that they are fair and reflect a consistent application of the policies and regulations for which we are responsible. In addition, we have on many occasions communicated to our member institutions that any decisions, judgments or other matters with which they are not satisfied can be brought to senior management's attention and we will personally review all circumstances in detail. In our view, a formal arbitration process on top of these many safeguards would be redundant, time consuming and an unnecessary expense for our institutions. On the other hand, affirmation of the regulatory review process already in place at the Dallas Bank would receive our support.

CONCLUSION

I would like to close with some summary observations about the situation overall in our district and about the Federal Home Loan Bank System's ability to help itself, as it has since the System was created 55 years ago.

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There is no doubt that the challenges we face today are serious, both for the industry and for the public it serves. The strongest step that can be taken to address the problems at hand is recapitalization of the FSLIC, to provide us and the other Federal Home Loan Banks with the tools necessary to handle the cases that are on our doorstep.

The most compelling reason that recapitalization is needed at this time is that the public's confidence in savings institutions and in the FSLIC is being weakened unnecessarily. The frank and open discussions of the resources of the FSLIC and of the regulatory processes have been necessary to Congress in its deliberation and oversight role. However, the discussions surrounding the FSLIC and its needs have gone on for quite some time, and the negative news is taking its toll. In our district alone, consumer inquiries relating to the health of the FSLIC have more than tripled in the last two years. This does not account for the increase in inquiries about the health of individual institutions which are up more than 200 percent in the same period.

The question is, how much more disclosure of the bad news will the public accept until they see affirmative action to deal with the situation?

The thrift industry has earned and deserved the support of the

American people over the years. We believe too that the Federal Hiome Loan Bank System has earned and deserved that trust and support. The reason that the industry exists as federally insured/publicly chartered institutions is to provide a public service; this Committee's constituency and ours are the same.

The Federal Home Loan Bank of Dallas' Statement of Purpose points clearly to this fact:

"The Pederal Home Loan Bank of Dallas serves the public interest by supporting the thrift industry with quality regulatory oversight and banking products and services that enhance the industry's profitability and financial soundness in the provision of affordable housing, community services and other needs as defined by Congress."

It is our view that recapitalization under the Administration plan will serve the public interest. This plan, which we support fully, is just one example of the self-help programs that the thrift industry and the Federal Home Loan Bank System have pursued. There are many other examples of these self-help efforts that are in effect. We have already talked about the issue of forbearances that are, in practicality, in existence, and these are certainly one way that the System is helping itself within the parameters that are available. There also have been a large number of regulatory approaches adopted by the Federal Home Loan Bank Board, again to help the industry through difficult

times in order to maintain sound and profitable operations.

Firm, fair and consistent regulation is also an evident form of self-help from the industry's regulators.

The Federal Home Loan Bank of Dallas also has a number of other facets to its operations in addition to our regulatory responsibilities. The President and Principal Supervisory Agent of the Dallas Bank manages both the banking and regulatory responsibilities of our organization. From the banking side, we provide substantial support to the industry, using the resources of the Bank, which are of course, the resources of the industry.

One aspect of our System's approach is to ensure that an institution does not default on an obligation. The Federal Home Loan Bank of Dallas has been advancing funds to financially troubled member institutions, carrying out our mandate as a lender-of-last-resort. In some cases the Bank's loans have not been as fully secured as is our normal credit practice. In these situations, the loans have been guaranteed by the FSLIC as well as being secured by collateral the institution is able to pledge to the Bank. The Bank has been called upon in emergency situations to provide credit, which we have readily and willingly done, to ensure that an institution does not have to face a liquidity problem. Moreover, for those institutions that have encountered significant withdrawals because of adverse publicity or other factors, the Bank has had coin and currency ready and available to deliver, a capability available because of our

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existing correspondent banking relationships.

It is important to recognize that the Federal Home Loan Bank of Dallas is privately owned by the thrift institutions in our district. We have a fiduciary responsibility to our stockholders to manage the Bank profitably and prudently. In taking some of these special actions for troubled institutions we have made decisions in our credit and banking capacities that are in the public's interest and at the same time increase the risk exposure to our organization. It is becoming increasingly difficult to keep this risk within appropriate and manageable limits. Yet, again, this is another way the Federal Home Loan Bank System is able to help the industry help itself.

We are also developing a series of other initiatives to assist member institutions in our District maintain liquidity and replace high cost funds with lower cost funds. Two of these initiatives are in the early stages of implementation — the "As-Agent Certificate of Deposit Program", and a program to attract funds from retail customers of securities dealers. These programs are designed to provide additional sources of funds to insolvent and other targeted institutions, in turn reducing pressures on interest rates and assisting in a return to a more traditional, well-managed operation. These programs seek to replace high-cost volatile funds that have been obtained in the national marketplace, approaches which had the impact of driving rates up in many markets, increasing the cost of funds for

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troubled institutions and, ultimately, to the FSLIC.

In the As-Agent Program, the Federal Home Loan Bank of Dallas acts as agent for stronger members, placing funds of those members in insured deposits in targeted, troubled institutions. As devised by the Federal Home Loan Bank of Dallas, and approved by the Bank Board, the Program's purpose is to invest the excess liquidity of financially strong member institutions in financially troubled institutions in the Ninth District in order to provide those troubled institutions with a source of reasonably priced deposit liabilities. This program is being implemented at this time.

The other program has essentially the same goal — that of taking some institutions that are paying well above market rates out of those high rate markets. The focus is to try to reduce costs to the targeted institutions and in turn reduce the costs to the FSLIC, costs that are ultimately borne by the thrift industry itself. The program features securities dealers purchasing a single, large certificate of deposit or a series of deposits in a financially troubled institution and selling the certificates of deposit or participations therein, in insured amounts, to their retail customers. The arrangement is backed partially by a letter of credit of the Federal Home Loan Bank of Dallas. A similar program is also being implemented in the Eleventh District. If these programs prove successful in the Ninth District, we would expect to offer this program nationwide to

provide new sources of reasonably priced funds to troubled institutions for liquidity purposes, and to significantly reduce the costs to FSLIC as it resolves the problems of these institutions through financial assistance, merger, or liquidation and payout of insured accounts. Other initiatives being studied to achieve these goals include CD-backed bonds and the use of electronic funds CD networks.

We also view as very important our responsibility to maintain an open communication system with our member institutions. One recent activity of the Dallas Bank was a series of six meetings to which all Texas savings institutions were invited to have one representative to discuss with our top regulatory staff major issues of concern in this complex environment. During this series of meetings we distributed an questionnaire. Approximately 130 people responded without identity. Some of those results should be interesting to this Committee. When asked what these institutions' overall view of the Federal Home Loan Bank of Dallas' recent regulatory efforts were, 70 percent said that they believed that their institution's views and opinions received fair consideration by the staff of the Bank and 74 percent indicated that they thought the Bank's regulatory approach was appropriate. In addition, 64 percent believed that the press did not accurately portray an industry-wide viewpoint of overkill.

Support for a recapitalization measure was overwhelming with 91

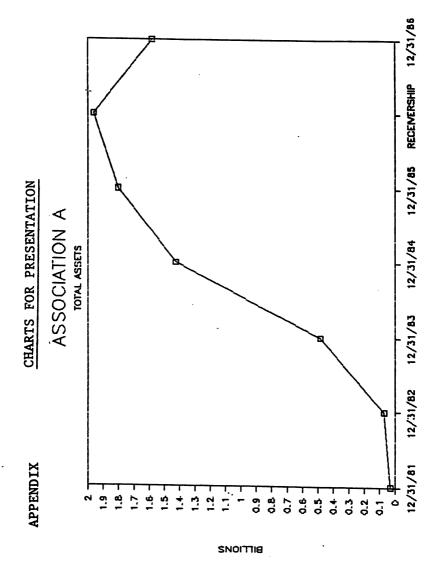
percent of the respondents favoring the need for one of the self-help programs proposed. When asked how their institution would be changed if hopelessly insolvent thrifts were resolved through a FSLIC-assisted transaction, 91 percent said that their net bottom line results would be improved or unchanged.

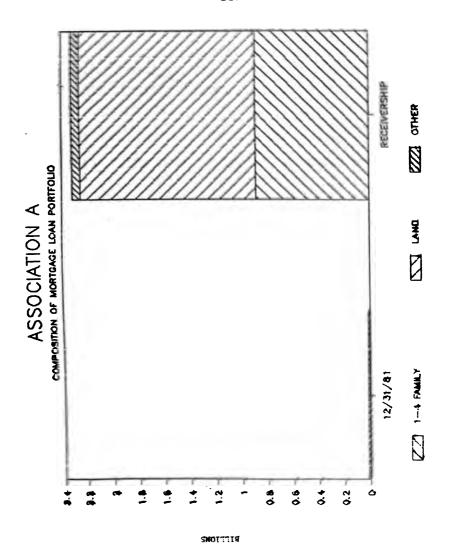
Moreover, when asked for their single preference for a regulatory approach to the case of hopelessly insolvent thrifts, 76 percent said that they would favor a permanent solution, such as a financially assisted sale/merger or a liquidation; this compares to 16 percent that would prefer a program of granting forbearances and 8 percent that feel a holding pattern/management consignment program approach would be the desirable solution.

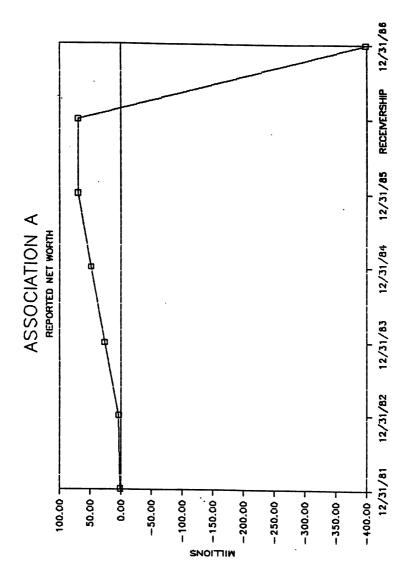
We are particularly pleased to bring these issues to your attention in this forum. The Federal Home Loan Bank of Dallas features both banking and regulatory functions; one of the greatest strengths of the Federal Home Loan Bank System is that both functions are centered in one agency and as a result an integrated approach to resolving industry concerns and problems can be pursued quickly and efficiently.

The Federal Home Loan Bank System is truly a system that provides self-help to the thrift industry. The single most important action the Congress of the United States can take at this time is to pass recapitalization to ensure that the System is able to continue in this vein. The depositors in America's federally

insured savings institutions deserve rapid consideration of this measure so that our nation's thrift industry as a whole will be able to continue to remain strong and meet its congressionally-mandated requirements for providing affordable home ownership and other community services.







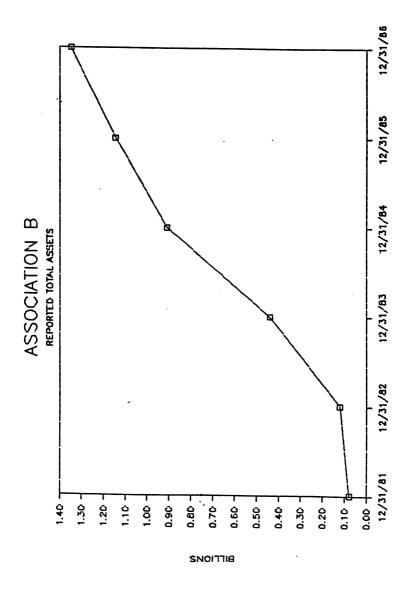
ASSOCIATION A

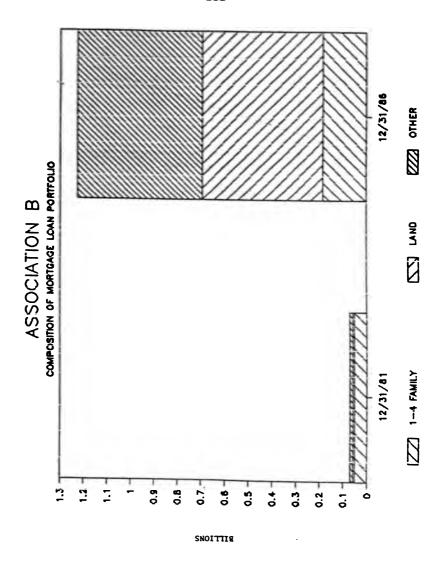
TOTAL KNOW COMPENSATION AND DIVIDENDS PAID TO OWNER \$3 MILLION

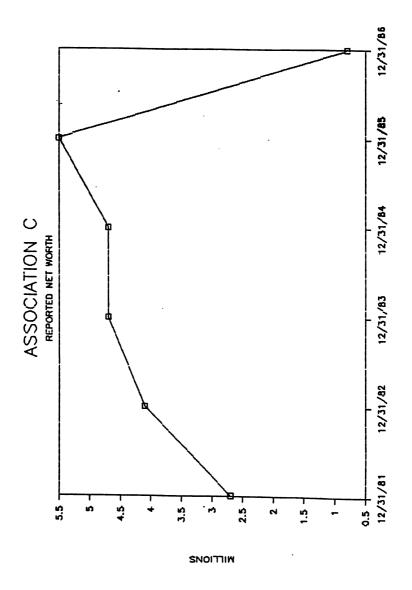
TOTAL LOANS DELINQUENT 60 DAYS OR MORE AND FORECLOSED OR REPOSSESSED ASSETS

\$800 MILLION

TOTAL LOAN LOSSES
\$350 MILLION







ASSOCIATION C

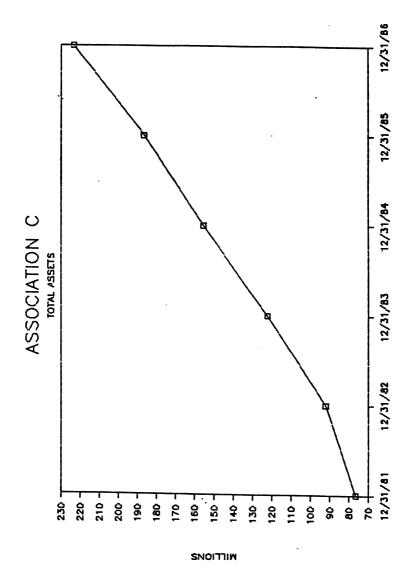
TOTAL KNOWN COMPENSATION AND DIVIDENDS PAID TO MAJORITY STOCKHOLDER \$250 THOUSAND

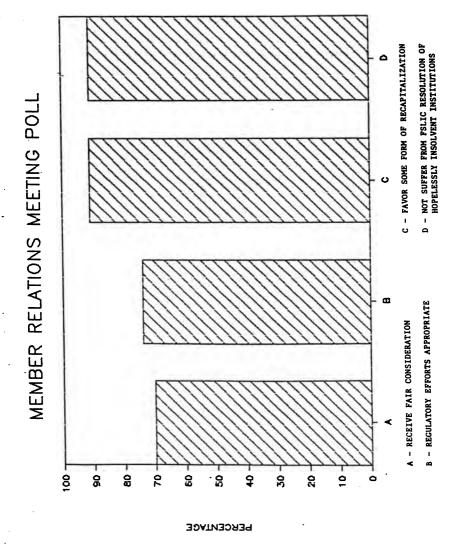
TOTAL LOAMS DELINQUENT 60 DAYS OR MORE AND FORECLOSED OR REPOSSESSED ASSETS

\$61 MILLION

TOTAL LOANS

\$2 MILLION





STATEMENT OF

TEXAS SAVINGS & LOAN LEAGUE

AND THE

U.S. LEAGUE OF SAVINGS INSTITUTIONS

PRESENTED BY

W. W. MCALLISTER III

BEFORE THE

COMMITTEE ON BANKING, FINANCE & URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.
MARCH 3, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is W. W. McAllister III, Chief Executive Officer of San Antonio Savings, a \$2.7 billion dollar institution headquartered in San Antonio, Texas. I am President of the Texas Savings and Loan League and also represent today the U.S. League of Savings Institutions where I chaired the Subcommittee on Regional Problems as part of a task force on current issues confronting the FSLIC. The complete text of the task force report was provided to the Committee on January 21 when I assisted Mr. Gerald Levy in his earlier testimony on behalf of the U.S. League, the major national trade association for savings institutions.

The Texas Savings and Loan League is comprised of 270 savings and loans domiciled in the State of Texas with approximately \$97 billion dollars in assets. These 270 institutions represent over 8% of the total assets of FSLIC insured savings institutions in the United States.

In developing an understanding of conditions in Texas, it is constructive to review economic conditions over the past four years.

The need for forbearance for institutions located in or holding assets originated in areas experiencing regional economic problems is more easily understood with a brief overview of changes in the Texas economy in the past four years. The index that most directly affects lenders in any regional economy is the growth of jobs and employment in a particular region. The Texas Employment Commission in its Texas Labor Market Review publishes figures reflecting job growth in Texas over the past four years and this gives a tremendous insight into what has taken place within the Texas economy. During the years 1983, 1984, and 1985, Texas created 144,900 jobs, 314,800 jobs, and 64,100 jobs respectively (See Appendix). During 1986, the state of Texas had a net loss of 163,200 jobs or 2.5% of the job base in the entire state.

It has recently been reported that Texas and Louisiana together produced 14 of the 25 highest metropolitan unemployment rates in the Nation last year according to a Bureau of Labor Statistics report. The Texas border area of McAllen-Edinburg-Mission, ended the year with the highest unemployment rate in the Nation - 20.3%, or one in five of the workforce unemployed. Odessa ended the year with a 14.9% unemployment rate, Beaumont-Port Arthur ended the year slightly better with a rate of 12.5%, but still with one out of eight people out of work.

The statistics for bank failures in Texas have grown at a geometric rate. In the first two months of the year, ten banks have failed in Texas. The entire financial infrastructure of the state is in danger.

Our company recently took over, in a FSLIC-assisted transaction, the Magic Valley Savings and Loan whose headquarters in Weslaco were in the same border area previously mentioned of McAllen-Edinburg-Mission. On Friday, February 20, federal regulators closed the First National Bank of Weslaco containing approximately \$70 million in deposits and located across the street from our new office. The FDIC is busily cutting checks to pay out the 14,000 accounts in this institution and as our employees look out the door, they can see the lines extending half-way around the block. This is the second failure of a bank in the Texas Rio Grande Valley within the past few months since Edinburg State Bank failed approximately six months ago. As our employees have talked to these people in the lines, the frightening thing is that a number of them have lost complete faith in all financial institutions in their region. The point I am trying to make is that few things are more alarming in an already precarious local economy than the residents' loss of faith in their own financial institutions.

Although I have mentioned only Texas and Louisiana, these states, as you know, are hardly alone in their plight: the terrible distress currently plaguing the energy and agricultural sectors has wreaked havoc from the Rio Grande to the Canadian border, creating regional economic conditions unrivaled since the 1930s.

Fortunately, however, there is no credible evidence that this downturn is other than a cyclical phenomenon; one would be foolish in the extreme to write off the economies of the affected states, which are rich in human and other resources.

Likewise, it would be foolish for the FSLIC, with respect to its supervision of savings institutions sharing in such severe but temporary regional economic problems, to fail to adopt policies that take advantage of the inevitability of a market rebound. Undeniably, there are institutions in the states in question that are dead or dying of self-inflicted wounds. Nevertheless, it is also undeniable that there are a great many institutions now experiencing financial problems in these distressed states that are guilty of nothing more than failure to predict the inherently unpredictable, and that have the managerial resources, if they are given the time to use them effectively, to work their way out of their current problems and greatly reduce the problem caseload and resolution costs of the FSLIC.

Obviously, it is totally in the interests of the FSLIC, given its financial and personnel constraints, not to put viable institutions out of business. The whole thrust of our forbearance concept is that the FSLIC should embark upon a policy that consciously recognizes its own self-interest in this regard, and focus its supervisory energies on truly serious cases, while accommodating the need of well-run organizations for regulatory patience and support in dealing with severe but transitional problems.

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Of course, making the judgments central to an effective forbearance program will be very challenging for the relevant supervisory officials. I am confident, however, that the human talent within, and obtainable by, our examination and supervisory apparatus is such that the job can be done. Certainly, the job performed by federal and state regulators in Texas in dealing with the effects of deregulation speaks very highly of those officials' competence and determination. There is no reason to assume that they would not be equally successful in implementing a policy designed to evaluate institutions' prospects, not just on the basis of snapshot financial data, but in terms of managerial quality and other factors equally vital to organizational viability.

Let me stress in this regard that the recent delegation of the FHLBB/FSLIC examination function to the Federal Home Loan Banks, which freed that function from highly counterproductive OMB and OPM limitations, has placed our Federal supervisors in the best possible structural position, from a personnel standpoint, to deal with the complex demands of a forbearance program—including the continuing overall need to make swift and effective use of available supervisory tools against any entity that displays "high flier" tendencies.

However, I believe there are fundamental problems with utilizing the existing regulatory accounting format in dealing with the current economic downturns. Its emphasis on appraised values rather than Generally Accepted Accounting Principles (GAAP) in establishing loss reserves serves only to exacerbate existing problems. This emphasis forces lenders to evaluate their portfolios as though all properties securing troubled loans would be instantly liquidated in the present depressed real estate market. In the real world it is unlikely that this kind of mass disposition would actually take place, especially in currently depressed markets such as Houston, since 1) a sale in a depressed market actually maximizes the loss incurred by the seller and 2) such dispositions frequently prove literally impossible since a significant percentage of the same market segment is controlled by regulated institutions. Additionally, we are concerned that even if such mass sales were possible by institutions with heavy problem asset concentrations they run the risk of sparking a self-fulfilling round of further write-downs (in which all lenders would participate) because of an inability of the market to absorb all the properties being auctioned off by lenders.

While there may be little question that appraised value is the appropriate benchmark for purposes of underwriting new credits or for that matter dealing with isolated problem loans, I believe it is counterproductive as a basis for attempting to deal effectively with situations such as those facing certain segments of the industry. For example, the following table shows the substantial differences which can arise between appraised value under R-41b, c, or now d and the values used for GAAP accounting purposes. In this "real-life" example, on which the League will be happy to provide additional detail, the valuations for an apartment project by two MAI appraisers (in accordance with R-41b) and the association's auditors showed the following substantial variations:

VALUATION BY

<u>Description</u> Valuation	Original <u>Appraiser</u> \$19,600,000	Review <u>Appraiser</u> \$23,000,000	Auditors (GAAP) \$27,476,000
Excess Over Original Appraisal - \$ - %	N/A	\$3,400,000 17.3%	\$7,876,000 40.2%
Excess Over Review Appraisal - \$ - %	N/A	N/A	\$4,476,000 19.5%

These differences arise out of fundamentally different views of the appropriate horizon for valuing the underlying collateral. An R-41 appraisal asks the question, "What will the property bring in a near-term sale in today's depressed market?" Alternatively, a GAAP Net Realizable Value (NRV) computation addresses the question of whether the lender will ultimately recover its original investment in the property plus its cost of carrying the property until the market recovers.

For example, interest expense is frequently the largest single carrying cost in holding income-producing property.

Consequently, from a purely economic perspective, financial institutions are the logical near-term holders of such properties since they generally have access to lower-cost funds than prospective purchasers of distressed properties (e.g., the seven-year advance rate for the FHLB of Dallas currently stands at 7.96%). This fundamental fact is the theoretical foundation for the use of NRV valuations for GAAP purposes. In essence the theory holds that the profits represented by the difference between an institution's cost of funds and the rate at which it could lend those funds are future earnings which should be recognized in the year in which they arise.

Consequently, if the cost of money is 8% and the current rate on loans is 10%, then the association should record a loss in the current period only if it will fail to receive at least an 8% return over the projected life of the project, i.e., break even by recovering all its costs. Alternatively, a projected failure to make a normal profit on the project by receiving a return in excess of its cost, i.e. more than 8%, would reduce profits in future years but would not necessarily result in recording a loss in the current period.

It is this difference that produces a \$27,476,000 NRV valuation for GAAP shown in the above example (but no current loss because the project at least breaks even in future periods) as opposed to a valuation of somewhere between \$19,600,000 and \$23,000,000 by the MAI appraisers (which produces a current loss to allow for a "profit" in future periods).

In the current environment it is clear that the NRV model is much better suited to helping the industry regain its financial health and preserving the integrity of the FSLIC since the appraisal model is liquidation-oriented while the NRV model allows a longer-term view of the problem.

As pointed out in the U.S. League's FSLIC task force report, the purpose of a forbearance program is to allow lenders in markets which are temporarily depressed to make rational decisions about managing their problems and thereby minimize their losses. Experience has repeatedly shown that in periods of temporary economic dislocation those who can weather the storm are the ultimate winners since the absorption of inventories returns rentals to normal levels and the values of properties are restored. Unfortunately, the problems created by the current "fire-sale" regulatory accounting framework can become a self-fulfilling prophecy for disaster.

Few would argue that it is inappropriate for the FSLIC to be concerned with the capital adequacy of insured institutions or would deny that asset quality is an important ingredient in assessing whether an institution has adequate net worth. However, in the current situation various components of the regulatory framework have the effect of creating a downward spiral to insolvency.

For example: Assume an institution has \$100 million in liabilities and \$3 million in regulatory capital. In 1982 it made \$6.4 million in apartment loans to various borrowers secured by collateral with an appraised value of \$8 million resulting in a loan to value ratio of 80%.

On February 26, the Chairman of the Federal Home Loan Bank Board announced that the Board would undertake a series of initiatives to help deal with the problems of well-managed institutions in areas with economic difficulties. In general, the public statement shows evidence of a welcome major shift in the Chairman's attitude to the forbearance issue and, if implemented properly, could cover many of the concerns addressed by H.R. 1063, the statutory forbearance proposal also on the table.

In particular, we welcome Chairman Gray's stated intention to adopt the type of targetted capital forbearance approach put in place by the commercial bank regulators last year and the changes in the asset classification regulation that make it comparable to the requirements imposed on commercial banks.

However, the announced program falls far short of what is needed for several reasons. First, we note that forbearance should extend to significant concentrations of assets located in regions with severe temporary difficulties and not only to institutions located therein. Furthermore, although Chairman Gray has promised study of the Board's appraisal policies, the proposed R-41d memorandum remains a problem. According to our current information, it is not intended that the new appraisal standard would adopt the cost of funds instead of an entrepreneurial rate as the discount rate for projected future cash flows. As pointed out previously, this has been one of the major complaints with the rules under memoranda R-41b and R-41c.

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Thirdly, the proposal does not deal with the excessive write-downs that have already been required. It might be possible to remedy this situation by applying a revised asset classification system retroactively to assets that had been written down pursuant to those assets being placed in the so-called "doubtful" category in the current classification process. A system might be devised so that an institution could apply for the reinstatement of the full value of the asset and the establishment of general loss reserves, or otherwise adjust the carrying values. We certainly think that a reasonable amount of retroactive application would be needed to cure the problems already caused by the current flawed system.

Finally, the benefits of the changes in policy depend crucially on how they are implemented. For instance, the Bank Board Chairman's statement says that: "Examiners, and ultimately supervisory agents, would have more flexibility in determining whether a loss exists since the system would be less appraisal-oriented."

One of the problems with this approach is that mistakes by examiners in being too lenient are likely to produce little praise for those examiners whereas there is little downside from mistakes made in being too tough. It will take a very strong signal from the top to overcome this natural bias.

Indeed, it is obvious that the progress we have made to date in advancing the forbearance concept reflects in part the growing understanding on the part of a growing number of members of Congress that the funding legislation for the FSLIC should not be enacted until the Board adopts an acceptable program for dealing with the problems of institutions in depressed economic areas and minimizing FSLIC outlays. We endorse that viewpoint.

In general, we would prefer that the problems in this area be dealt with at the regulatory rather than at the statutory level. However, if the regulator is not willing to adopt appropriate policies and measures, then we believe it is necessary for the Congress to step in and force the necessary changes.

In particular, we endorse the proposal in H.R. 1063 that a thrift institution that is facing difficulties from the depressed state of a local real estate market rather than from mismanagement should be allowed to amortize the asset losses arising from such depressed conditions over a period of five to ten years. We note that the amortization of losses over a period of up to 20 years is currently being used in the Farm Credit System and that similar measures for amoritizing losses on agricultural loans over similar periods have been proposed for commercial banks in H.R. 1268 and H.R. 1310.

We believe that such a system can be put in place while still guarding against mismanagement and fraud. For instance, the ability to use the amortization method could be withheld from institutions where there is evidence of self-dealing, fraud, willful violations of laws and regulations, excessive growth or other irresponsible actions on the part of the institution's ownership, management or board of directors.

Secondly, a cut-off date could be used to determine which assets are eligible for the amortization treatment. For instance, only assets which were put on the books before a certain date -- December 31, 1986 or June 30, 1986, for instance -- would be eligible. In addition, any retroactive application of the loss deferral to assets that have already been written down would be a capital account transaction, with the benefits not being allowed to flow through the income statement.

Third, the deferral of losses could possibly be reflected only on reports filed with the Bank Board. Thus, for instance, publicly-traded companies would not be allowed to show the loss deferrals on financial reports supplied to stockholders. This is not to say that this limited ability to use the loss deferral would not be beneficial to qualified publicly traded companies since it could very well provide public auditors some measure of comfort in giving a going-concern opinion to such an institution.

With these safeguards, we believe that the loss deferral legislation would give well-managed institutions a chance to work out of their problems, lessen the demands on the FSLIC and help preserve the financial infrastructure in the areas of the country most severely effected by economic depression. At the same time, it would not diminish the ability of the regulators to assess the health of the institutions they supervise since the program would not hide the losses on the institutions' books. Instead, the losses would be shown on the balance sheet and then be expensed over the allowed amortization period.

In summary, we strongly believe that a program to buy time for well-managed institutions with asset holdings in economically depressed areas should go hand-in-hand with any funding program for the FSLIC and that the Congress should not pass any funding legislation until it has satisfied itself that the necessary reforms and forbearance are promulgated and will be adhered to by the Federal Home Loan Bank Board. Absent that assurance, we believe the Congress should chart the appropriate course for the Bank Board to follow.

APPENDIX

JOB GROWTH

NON-AGRICULTURAL WAGE & SALARY EMPLOYMENT

MAJOR METROPOLITAN AREAS

OF TEXAS

<u>SMSA</u>	NET CHANGE 1983	NET CHANGE 1984	NET CHANGE 1985	EST. NET CHANGE 1986(1)
Dallas	+69,400	+114,400	+50,900	(13,300)
Ft. Worth/Arlington	+25,500	+38,000	+24,500	+4,600
Austin	+29,200	+39,100	+18,400	(1,700)
Houston	(34,900)	+51,900	(21,300)	(89,900)
San Antonio	+21,600	+27,000	+17,600	+3,700 🧳
Balance of Texas	+34,100	+44,400	(21,400)	(66,600)
State of Texas	+144,900	+314,800	+64,100	(163,200)

Source: Texas Employment Commission, TEXAS LABOR MARKET REVIEW

(1) Subject to revision





FEDERAL HOME LOAN BANK OF DALLAS

Roy G. Green

April 3, 1987

Honorable Fernand J. St Germain U.S. House of Representatives Rayburn House Office Building Independence Avenue and South Capitol Street, SW Washington, D.C.

Dear Congressman St Germain:

As requested during our March 4, 1987 testimony before the U.S. House of Representatives Committee on Banking, Finance and Urban Affairs, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, the following information is submitted for insertion in the official record.

Line 2902 Date of Examination resulting in Supervisory Agreement on Association B was October 21, 1983.

Line 2935 Date of Examinations previous to the disclosure of Association B's problems were March 13, 1981 and

November 30, 1982.

In addition, I would like to respond to several questions which were posed during the testimony. You asked for information relative to the detection of problems at the three case studies presented in our testimony. (See Page 66, line 1542). As can be seen on the enclosed information (Enclosures A, B, C and D), the Financial Systems reports on both Association A and B did not disclose problems during 1982 and 1983. In retrospect, this was because the institutions were inflating net work with large upfront fees that were funded from loan proceeds. During 1984, an improved reporting system, called the Financial Viability Examination System, was implemented which flagged nontraditional investments such as acquisition and development loans, nonresidential mortgages and exposure to subsidiaries. In addition, the system disclosed high levels of wholesale funds and off balance sheet commitments and contingencies. However, the Agency lacked the regulatory authority to effectively deal with these practices until the regulations pertaining to direct investments, liability growth and net worth compliance were adopted by the Federal Home Loan Bank Board during 1985. Within institutions A and B, the eventual result of those practices was the deteriorated financial conditions of the institutions and significant potential cost to the Federal Savings and Loan Insurance Corporation.

Honorable Fernand J. St Germain

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During 1982 and 1983, Association C experienced spread problems as a result of the rising cost of funds and the substandard performance of construction loans which were granted for the development of unsold single family housing. As interest rates declined, the sale of such housing units has improved and operating results began to rise. However, Association C continues to experience problems as a result of the energy orientation of the local economy. Such problems continue despite the excellent management of the institution. We believe that our decision to forbear was and is the appropriate posture to take in regulating this institution and that it will eventually recover from its present problems.

Representative Barnard asked for the following information on the amount of growth at each of the three cases which were presented that is attributable to direct investments:

Association A \$184,700,000
Association B \$144,650,000
Association C \$11,650,000

These figures represent the amount of direct investments reported by the institutions as of December 31, 1986, as defined in 12 C.F.R. § 563.9-8 (1987).

H. Joe Selby and I appreciated the opportunity to testify before the Committee and look forward to working together as we serve the public interest.

Should any further information be required, please contact me or ${\tt H.}$ Joe Selby at your convenience.

Roy G. Green

Ton President

and Principal Supervisory Agent

enclosures

- A. Financial Information System-Association A
- B. Financial Information System-Association B
- C. Financial Information System-Association C
- D. Financial Viability Examination System-Association A, B, and C

cc: Office of General Counsel Federal Home Loan Bank Board United States General Accounting Office

GAO

Testimony

For Release on Delivery Expected at 11 a.m. EST Tuesday March 3, 1987 The Federal Savings and Loan Insurance Corporation -- Financial Condition and Recapitalization Issues

Statement of Frederick D. Wolf, Director Accounting and Financial Management Division

Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance Committee on Banking, Finance and Urban Affairs

United States House of Representatives



GAO/T-AFMD-87-4

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear today to discuss your proposed legislation (H.R. 27) "Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987", to provide some observations about the conditions that have made recapitalization necessary, and to offer our views on some actions the Committee should consider to maintain the financial health of the savings and loan industry and the Federal Savings and Loan Insurance Corporation (FSLIC) fund.

CONDITION OF THE SAVINGS AND LOAN INDUSTRY

Almost from the time of its inception in 1934 until about 1979, the savings and loan industry and FSLIC experienced relatively few problems in comparison to today. During those 45 years, FSLIC provided assistance to only 124 institutions, and in only 13 cases were a savings and loan (S&L) association's problems so severe that it was necessary to close the institution and pay its insured depositors. During that time, the thrift industry operated in a relatively simple environment in which deposits generated from the local economy at regulated rates of interest were invested in traditional home mortgages.

However, beginning in the late 1970's, the environment changed dramatically as restrictions on deposit rates were progressively lifted, and escalating competition for deposits

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resulted. S&Ls were forced to pay increasingly higher interest rates to preserve their core deposits, while at the same time being encumbered with low-yielding loan portfolios.

Because of this interest-rate spread, thrifts experienced large operating losses and capital depletion, which many sought to correct by making high-risk investments for higher rates of return. Since 1983, FSLIC has observed many of these institutions encountering problems resulting from having to absorb substantial losses on those high-risk investments. The outcome has been an alarming number of S&L failures. From 1981 to 1986, 211 S&Ls were merged with other institutions or liquidated; and the number of insolvent S&Ls (using generally accepted accounting principles) increased from 16 in 1980 to 445 as of September 1986.

It is important to point out, however, that whereas the large number of failures and insolvencies is alarming, a substantial segment of the industry is both solvent and profitable. As of September 1986, the latest information available, about 85 percent of FSLIC insured S&Ls were solvent, while only 15 percent were insolvent. At the same time, about 80 percent of S&Ls were profitable, earning \$6.9 billion during the first three quarters of 1986, while the unprofitable 20 percent segment incurred losses of \$5 billion.

Diversification Into Nontraditional Assets Has Severely Weakened Some S&Ls' Portfolios

With legislation in the early 1980's liberalizing the types of activities in which S&Ls could participate, many S&Ls began to diversify their asset portfolios away from traditional residential mortgage loans and into other activities, including direct investment, that are far removed from home mortgage lending activities. Such investments, although potentially more lucrative, are recognized as inherently more risky.

In 1985, after having observed the disastrous consequences of some institutions that became heavily involved in high-risk equity investments and in an attempt to limit the industry's exposure to these higher risks, the Federal Home Loan Bank Board implemented rules to require state-chartered S&Ls to obtain FSLIC approval for investments that would cause them to exceed certain investment-to-asset ratio thresholds. We support that rule.

However, because of the asset quality problems that we have observed at failed institutions, we are concerned that some S&Ls are entering into arrangements which, while technically classified as loans, still carry many of the risks associated with equity-type investments but do not require FSLIC approval. Let me briefly discuss some of the activities to which I am referring.

The following three S&L failures illustrate the kinds of asset degradation we have observed.

Empire Savings and Loan

In September 1981, Empire began lending money to investors to finance speculative acquisition of land. Empire also made many construction loans to develop condominium communities in Texas.

In January 1981, Empire's assets totaled \$12 million; by December 1983, its assets had grown to \$315 million. On March 14, 1984, the Bank Board closed Empire due to insolvency. At the time of closing, Empire had 317 outstanding construction loans, almost all of which were delinquent. It also had 658 loans to investors used to finance the purchase of completed, but unoccupied, condominium units. Most of these loans were also delinquent. Losses resulting from the failure of Empire's borrowers to repay the loans are expected to exceed \$142 million, or 45 percent of the book value of Empire's assets at the time of its closing.

Beverly Hills Savings and Loan Association

The Beverly Hills Savings and Loan Association, in Beverly Hills, California, was another thrift that attempted to shift its

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portfolio from traditional home-ownership and consumer loans to high-risk land development, commercial, and industrial ventures. In only two years, Beverly Hills tripled its asset size, from \$834 million at the end of 1982 to \$2.9 billion at the end of 1984, primarily through real estate ventures and other nontraditional activities. In April 1985, the Bank Board closed the state-chartered thrift because of insolvency and reopened it as the federally chartered Beverly Hills Federal Savings and Loan.

To obtain a return high enough to cover interest costs on the deposits used to finance its explosive growth, Beverly Hills sought investments providing higher yields than those provided by traditional mortgage lending activities, with a consequent increase in the risk of loss. These investments included real estate, both development and operating properties which were held directly or through joint ventures; construction loans; and high-yield, low-investment-grade bonds often referred to as "junk bonds."

First South Savings and Loan Association

The Bank Board closed First South Savings and Loan of Pine Bluff, Arkansas, in December 1986 because of insolvency. About 18 months before its closing, First South management embarked on an expansion program, selling most of its traditional

collateralized real estate and commercial loans and other marketable assets to obtain cash which it then "lent" for highly speculative projects throughout the nation. When FSLIC took over, about \$900 million, or 64 percent of First South's \$1.4 billion portfolio, was in speculative investments. Most of these loans were in default and were outside the Arkansas market. In contrast, only about 9 percent of First South's loans were for residential mortgages.

To add to First South's problems, its lending activities were concentrated in loans to 13 borrowers who owned or controlled over 50 percent of First South's stock. The bulk of First South's lean losses were attributable to such loans, which comprised more than 40 percent of First South's unsecured, commercial, and commercial real estate loans.

Insolvent, Unprofitable S&Ls Continue To Operate

Although a number of S&Ls are insolvent, or nearly insolvent, and unprofitable, they continue to operate. At September 30, 1986, of the 445 operating S&Ls that had a GAAP net worth of zero or less, 297 were unprofitable. In addition, another 598 institutions had a GAAP net worth of between 0 and 3 percent, and 198 of these were unprofitable.

In an attempt to preserve FSLIC's resources, the Bank Board has been forced to allow these S&Ls to operate even though many may never regain solvency or profitability. FSLIC has also had to provide a substantial amount of assistance to troubled institutions in the form of loans, contributions, and net worth or income capital certificates, or various combinations thereof. Since 1981, FSLIC has used these types of assistance extensively and, as of December 31, 1986, has provided \$6.9 billion through these various types of "open assistance" programs.

Delay Increases Ultimate Resolution Costs

Delaying necessary regulatory actions, including closures where warranted, only increases the ultimate cost of resolving the industry's problems. FSLIC's costs to liquidate failed S&Ls have risen from relatively negligible amounts in the 1970's to 37 cents per dollar of acquired assets in 1982 to 50 cents in 1986. In the early 1980's, the problem facing the industry was interest-rate spread. Given the prospect that interest rates would decline, delay was not unreasonable. Today, however, the majority of current cases requiring FSLIC action are asset quality problems rather than interest-rate spread problems. Asset quality problems are potentially more dangerous to the insurance fund than are interest-rate spread problems and can be more difficult to deal with. A single large defaulting asset could quickly wipe out an institution's entire net worth.

Moreover, in contrast to interest-rate spread problems which improve when inflation declines, an S&L with asset quality problems is less likely to recover simply from a return to economic prosperity, especially when inflation also subsides.

In general, we have seen that asset quality problems are both less predictable and more costly to the insurance fund than interest-rate spread problems. Perseverance is no virtue for an institution with poor credit risks, bad assets, and a worsening insolvency problem. Furthermore, delay has two immediate and obvious costs. First, every dollar of continuing losses by an insolvent thrift adds to FSLIC's cost and creates a growing imbalance between the liabilities for which PSLIC is responsible and the assets it must manage at the time of case resolution. Industry data show that the thrifts in FSLIC's significant supervisory caseload are losing \$6 million a day, or \$2.2 billion a year. Secondly, according to the Bank Board, insolvent S&Ls are bidding up deposit rates, not only for themselves but also for healthy institutions as well. Thus, the cost of funds for the whole industry is raised, which results in slimmer profit margins or larger losses. The solvent and profitable sector, therefore, is being hurt by FSLIC's continued inability to adequately address the problems of the troubled sector.

IMPACT ON FSLIC'S FINANCIAL STABILITY

The interest rate spirals of the early 1980's and the severe asset quality problems that have since surfaced have resulted in a growing number of S&L insolvencies or near insolvencies. This situation has had a devastating impact on FSLIC's caseload of problem S&Ls, FSLIC's future costs, and on its ability to resolve them. The Federal Home Loan Bank Board's Significant Supervisory Institutions caseload includes 362 institutions with assets of \$103 billion.

FSLIC's insurance fund has steadily declined during the last 5 years from \$6.3 billion in 1981, to a deficit position in 1986. As part of our audit of FSLIC's calendar year 1986 financial statements, we have preliminarily determined that FSLIC needs to establish a contingent liability in the range of \$8 billion to handle cases that will require action in the near future. When this amount is deducted from FSLIC's reserves, FSLIC would have a deficit of over \$3 billion as of the end of 1986. Clearly, such a fund balance cannot handle the real liability FSLIC now faces.

During the 1981 to 1986 period, FSLIC incurred expenses for insurance settlements and interest on notes payable to insured institutions amounting to \$643 million, while spending \$3 billion to provide assistance under contribution agreements related to assisted mergers and acquisitions. These expenditures have not

only adversely affected FSLIC's reserves but have also caused a severe decline in its liquidity. As of December 31, 1986, FSLIC had about \$4.0 billion in cash and other liquid assets, but it had notes and accounts payable to insured institutions of \$5.0 billion. Most of these payables are held by institutions in FSLIC's Management Consignment Program (MCP) and by de novo Federal Mutual Associations that emerged from partially resolved asset backed transfers (ABT). To completely resolve the MCP and ABT cases will require FSLIC to sell them to or merge them with an adequately capitalized acquiror and to replace the notes with cash that FSLIC does not currently have.

In 1986, FSLIC acted on only about half of its serious cases. During the same time, its serious case list doubled in size. At December 31, 1985, FSLIC had 93 cases involving S&Ls that it considered to be in serious financial trouble. One year later, the list virtually doubled to 183. Of the 93 cases as of December 1985, FSLIC was able to act on only 49 during 1986—9 were placed into the Management Consignment Program and may require additional action in the near future, 23 were acquired by or merged with other institutions that may later require assistance, and 17 were closed. Forty-six of the institutions on the December 1985 list were still on FSLIC's list at the end of 1986.

During 1986, dramatic increases were evident in several aspects of FSLIC's assistance programs. Specifically, from 1985 to 1986

- -- the number of institutions FSLIC closed increased from 10 to 21,
- -- the cost of liquidations increased from \$981 million to \$3 billion,
- -- FSLIC's claims on assets of closed institutions rose from \$2.5 billion to \$7.8 billion, and
- -- assistance to open institutions rose from \$4.8 billion to \$6.9 billion.

In summary, FSLIC's reserves for dealing with such problems have steadily declined and, with the additional loss provision expected to be necessary, FSLIC will be in a deficit position. This decline, coupled with FSLIC's sharply higher and increasingly expensive caseload, illustrates the urgent need to infuse new funds into the Corporation. According to a recent statement by the Chairman of the Bank Board, FSLIC will need \$23.5 billion to resolve known and borderline cases requiring assistance.

REGULATORY ACTIONS TAKEN TO RESOLVE PROBLEMS

Since the problems in the S&L industry first became publicly recognized in the early 1980's, the Bank Board and FSLIC have experimented with assorted regulatory techniques, such as relaxing accounting regulations, to postpone resolution of them. These regulatory changes did provide breathing space, enabling some institutions experiencing interest-rate spread problems to recover. However, the changes also contributed to permitting other S&Ls time to engage in imprudent and speculative activities. Various industry groups are now proposing further rule changes and a forbearance program as a further attempt to prop up the failing segment of the industry. I would like to briefly discuss both of these proposals.

Further Accounting Rule Changes Will Not Solve Problems

In 1981 and 1983, as a response to problems in the S&L industry, regulatory accounting principles (RAP) were relaxed to allow S&Ls time to work out problem loans and other poor quality assets. Various groups are now proposing changes that would again weaken accounting and reporting procedures. We oppose any such changes and firmly believe that S&Ls should follow generally accepted accounting principles (GAAP).

Relaxing the accounting and external reporting rules of depository institutions results in a misleading picture of the true financial condition of the institutions and does not solve the economic problems in the industry. Although we do not take issue with the need for institutions to work out acceptable recovery programs, we believe that accounting and financial reporting should remain neutral and not become part of the mechanism to deal with troubled institutions or their problem debt. The Congress, regulators, investors, and the general public, all need clear and accurate reporting, in accordance with GAAP, to make the best decisions possible in response to the magnitude of the problems that S&Ls face.

One proposal put forth is to allow S&Ls to amortize loan losses over a period of up to 20 years instead of recognizing them in the period actually incurred, as required by GAAP. Although this practice would improve the appearance of an S&L's financial position, it is not a true picture because it does not reflect the total cost of operations.

We oppose that proposal as we did when similar legislation was proposed for the Farm Credit System. On October 6, 1986, the Comptroller General wrote to the Chairman, House Committee on Agriculture, voicing his concern over the Farm Credit System proposal. Specifically, the Comptroller General noted that such a proposal would hide the very serious financial problems that

the industry faces. Although the current proposal may have short-term salutary effects on the S&Ls financial condition, the short-term benefits will be far outweighed by the long-term costs of failing to deal with financial problems in a direct and forceful manner. The danger of such action is that regulators and others may begin believing the fiction that is created, which, in turn, will slow if not halt efforts toward reform. A copy of our letter is attached for the record.

Another proposal suggests wide-spread use of the principle espoused in Financial Accounting Standards Board Statement No. 15 (FASB 15), "Accounting by Debtors and Creditors for Troubled Debt Restructuring," to account for problem loans. FASB 15 is a much misunderstood accounting principle. Its proponents have often erroneously assumed that FASB 15 would allow S&Ls to avoid loan loss recognition on restructured loans to a greater degree than actually allowed by that principle. Although we do not disagree with the need to occasionally restructure loans to minimize losses, application of FASB 15 does not allow S&Ls to avoid losses. Under another generally accepted accounting principle, FASB 5, "Accounting for Contingencies," management and its auditors are responsible for fairly reporting the value of assets, including restructured loans, by properly accounting for uncollectible amounts. To the extent that portions of the restructured loans are not considered likely to be collected,

under FASB 5, a reserve must be established for the uncollectible amounts.

A second point to note is that FASB 15 is a relatively liberal accounting principle that does not require a reduction in the carrying amount of the loan unless future cash receipts will be less than the recorded investment in the loan, even though by restructuring loans, an S&L can incur a substantial loss in future periods. To illustrate our point, suppose an S&L has a \$10 million loan repayable in 1 year with interest at 10 percent. The S&L could modify the loan terms so that the loan is repayable in 10 annual installments of \$1 million with no interest. Under FASB 15, the S&L would recognize no loss because the \$10 million to be repaid equals the \$10 million investment in the loan. Clearly, however, the S&L will not earn the \$1 million in interest that would have otherwise been paid, and it has lost the difference between the value of the \$10 million originally to be collected at the end of the year and the reduced value of \$10 million collected over 10 years. Of course, as noted, FASB 5 would still require the auditors to evaluate whether the 10 payments are collectible or not, and make appropriate reserves if they are not expected to be collectible.

Unfortunately, we believe, and other work we have done shows, that S&Ls have been far too slow in recognizing the uncollectible portion of their loan portfolios. Thus, to appear

to encourage a liberal use of accounting rules related to debt restructuring, without acknowledging the related need to continue to evaluate collectibility and take appropriate writedowns, just exacerbates the problem. This also puts enormous pressure on public auditors who are trying to assure proper financial reporting to the investing public and to depositors.

In conjunction with these proposals, another proposal has been put forth to allow S&Ls to include loan loss reserves as part of RAP net worth. As of September 1986, industry net worth on a RAP basis was 4.56 percent, while net worth on a GAAP basis was 3.61 percent. Due to the already wide disparity between GAAP and RAP net worth, and because we believe accounting information should be reported in accordance with GAAP to provide a true picture of an entity's financial position, we do not think a proposal to further increase the disparity between GAAP and RAP net worth would be wise.

Capital Forbearance

In the past several weeks, a number of proposals have been made for the Bank Board to adopt a policy of capital forbearance as a form of regulatory relief for S&Ls experiencing problems.

In a press release on February 26, 1987, the Chairman of the Bank Board issued a statement announcing a capital forbearance policy for the savings and loan industry. The Bank Board's announcement

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noted that its forbearance policy would be closely patterned after the commercial banking regulatory agencies' forbearance program for dealing with agricultural and energy banks. In considering the Bank Board's program, it is important to understand specifically how forbearance is applied in commercial banking and to note what it does and does not do:

In March 1986, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Controller of the Currency (OCC) announced a policy, commonly referred to as capital forbearance, which defers, in specified circumstances, normal regulatory action against well-managed, viable institutions whose net worth fall below the normal regulatory requirements. Essentially, the commercial bank forbearance policy permits well-managed institutions that have experienced declines in their primary capital ratios below the customary 5.5-percent requirement, and that have met the other requirements of the program, to continue operating without the normal regulatory actions. The capital forbearance program, as practiced in the banking industry, is primarily intended to provide a temporary moratorium for wellmanaged banks with sufficient capital to absorb loan losses and with reasonable prospects for recovery to rebuild their capital reserves. It is clearly not a program designed to prop up poorly run or insolvent institutions, or to mask or minimize financial problems. Instead, because participating banks whose capital ratios fall below normal regulatory requirements can operate

without fear of closure, one of the benefits expected of the program is to provide them with an incentive to promptly recognize losses arising in their loan portfolios.

The program is primarily targeted for institutions with a substantial portion of their portfolios in agriculture, oil, or energy loans. Other key features of the program are as follows.

- -- The program is available, only upon banking regulators' approval, to institutions whose capital ratios decline from the established 5.5-percent requirement to 4-percent. Exceptions can be granted to otherwise sound institutions with lower capital ratios. For example, FDIC may permit participation by an institution with a 3-percent ratio if it has good prospects for achieving a 4-percent ratio within 12 months.
- -- The institution's weakened capital position generally must have resulted from external problems in the agricultural, oil, and gas sectors of the economy, not from such factors as poor management, high operating costs, or excessive dividends.
- -- Participating institutions must provide a reasonable plan for restoring capital to required minimums by January

1993 and must file annual reports on their progress in achieving their plans.

Clearly, the commercial banking supervisory agencies have adopted a selective approach to capital forbearance, targeting it toward institutions with good chances of achieving strengthened financial positions. The program is definitely not intended to keep insolvent banks in business. To illustrate, as of December 31, 1986, FDIC has approved applications of 33 institutions, while disapproving those of 27 institutions seeking capital forbearance generally because FDIC did not think they would recover.

We recognize that a similar policy of capital forbearance might be a useful regulatory tool for the savings and loan industry. The Bank Board's newly announced plan, however, differs from that used by the commercial banking regulators in one major respect which causes us concern. The Bank Board targets eligibility for participation in the program to institutions with regulatory net worth as low as one half of one percent, as opposed to the 4-percent requirement for commercial banking. We think this proposal is too liberal. In our view, the Bank Board's capital forbearance program should not be significantly less stringent than that practiced by the commercial banking industry. Any actions by either thrift or banking industry regulators that confer a competitive advantage

on one of these industries at the expense of the other potentially weaken both and, as a result, increase the federal government's overall deposit insurance risk exposure.

GAO ANALYSIS OF RECAPITALIZATION PROPOSAL

We have recently completed an analysis of the Treasury/FHLBB proposal to recapitalize FSLIC and are releasing our report (GAO/GGD-87-46BR) to the Committee at this time. Therefore, I would just like to summarize our findings and conclusions.

Clearly, FSLIC needs additional funds to resolve the large backlog of insolvent and unprofitable S&Ls that continue to operate. With its insurance fund rapidly declining and in a deficit position, and with its substantial decrease in liquidity, without recapitalization FSLIC will be unable to keep its head above water, let alone resolve cases of failing institutions. Furthermore, FSLIC's inability to deal with the problems facing the S&L industry has had a detrimental effect on public confidence in the entire thrift industry. This lack of confidence has caused S&Ls to pay increasing interest rates on deposits, which may result in even higher future resolution costs to FSLIC. Moreover, this lack of confidence is readily apparent when comparing the deposit mix of solvent institutions with those of insolvent institutions. Insured deposits make up a much larger percentage of deposits in insolvent institutions than they

do in solvent institutions. Since FSLIC must pay off insured depositors when an S&L is liquidated, its costs may be much higher because of this disparity.

While we did not attempt to determine whether the \$25 billion to \$30 billion proposed in the Treasury/FHLBB plan is adequate to finance the resolution of known problems, our previous work, knowledge of the condition of the industry, and the Bank Board's own analyses suggest that a smaller amount would be too little. In our analysis, we therefore assumed that to be successful, the plan must be able to raise at least \$25 billion in the next 5 years.

Our analysis shows that the Treasury/FHLBB proposal can raise \$25 billion over 5 years without depleting the fund's reserves as long as FSLIC's income is augmented either by continuing special premium assessments, which are phased out over 5 years under the proposal, or by receipts from sales of assets acquired through liquidations. We wish to emphasize that this solution, however, virtually preempts FSLIC's future income stream to deal with current problems. Accordingly, if the industry were to suffer significant further declines—either from imprudent management at individual institutions or from adverse economic conditions—FSLIC would not have funds available to deal with the consequences. Given the inherent uncertainties in assessing future economic conditions, and the current pressures

to further liberalize regulatory guidelines, the emergence of further problems is a definite possibility. Therefore, the Congress should recognize that enactment of this legislation will not necessarily preclude the need for an additional infusion of capital at some future time. Despite these considerations, we do not oppose enactment of H.R. 27 because of the urgency we attach to the need for FSLIC to promptly deal with its inventory of failed and failing institutions. Delay can only increase the problem—and increase the likelihood for a further loss of public confidence in the industry.

In its deliberations on recapitalization, however, we believe the Congress should also consider requiring FSLIC to limit the industry's ability to enter into high-risk investments and loans. When these high-risk ventures fail—as many have and will probably continue to do—FSLIC and the profitable sector of the industry are left to pay the bill. We do not believe the Congress envisioned that FSLIC would be insuring S&Ls investing in high-risk activities to the exclusion of traditional residential mortgages to the degree some S&Ls have. In developing recapitalization, this Committee has an opportunity both to provide the funding FSLIC desperately needs now and to require FSLIC to take action that will reduce the potential that recapitalization will be required again at some future time.

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We believe the Congress should also address the following in setting up the FSLIC recapitalization plan.

- -- Ensuring congressional review and oversight of the FHLBB's and FSLIC's plans and actions, and providing some control mechanisms if the oversight process reports negative findings;
- -- Providing a means to ensure that sufficient funds will be available to pay the debt service if FSLIC premium income is inadequate; and
- -- Strengthening regulations and oversight to reduce the speculative-type activities that have resulted in the severe asset quality problems of the industry's troubled sector.

Mr. Chairman, this concludes our statement. At this time, we will be pleased to respond to any questions you may have.

ATTACHMENT I

ATTACHMENT I



United States General Accounting Office Washington, D.C. 20548

Comptroller General of the United States

October 6, 1986

The Bonorable E. (Kika) de la Garza Chairman, Committee on Agriculture Bouse of Representatives

Dear Mr. Chairman:

I wish to, convey my deep concern over recently introduced legislation that would allow the Farm Credit System to amortize over a period of 20 years the losses resulting from its poorly performing loan portfolio and the high current cost of its debt. This legislation, if enacted, could have the effect of hiding the very serious financial problems that the System will experience in the future. We estimate that the accounting changes allowed by the legislation could overstate earnings by 55 billion or more over the next 30 months.

Of more importance, adoption of this legislation could impede the speed of reforms to the management practices and operations of the Parm Credit System that were contemplated by the Congress when the 1985 amendments to the Parm Credit Act were enacted into law just 9 months ago. In addition to putting the System on a solid basis of financial accounting, the amendments were designed to achieve desperately needed reforms to credit evaluation and approval procedures. In effect, the legislation may turn the clock back to the earlier era of undisciplined accounting practices and loose credit analysis and approval.

I urge you to carefully weigh the effect of the proposed legislation on the long-run viability of the Farm Credit System. These amendments may have short-term salutory effects on the appearance of the financial condition of the System as well as the federal deficit. Bowever, reliance on legislatively sanctioned regulatory accounting in the thrift industry has taught us all too well that these short-term benefits may

ATTACHMENT I

ATTACHMENT I

be far outweighed by the long-term costs of failing to deal with financial problems in a direct and forceful manner. The danger here, as there, is that System officials will begin believing the fiction that is created, which, in turn, will slow if not halt efforts at reform.

Sincerely yours,

Charles A. Bowsher Comptroller General of the United States

Fuzzing the Farm Credit Problem

politicisms. for all the usual reasons, would rather it be later. The reaces bill that was hastily passed when the system's difficulties were ductosed last year required that the administrators first shalt around the masses of assuber benks, using the stronger to shore up the weaker. Only then would the government step in. In the measume the healts would have to modernize the easy lending and accounting practices that, along with the side in farm income and land values, helped produce the measure myshem. liticians, for all the usual reasons, would rather

chicens." a congressional more causes there is a chicens." a congressional more causes there is a chicens." a congressional more causes there is an other day. The bill will pass anyway it buys time, though notice can be charred up. Congress has means while been asked to rush through an alternative.

Critics note wryly that the request comes just

mently compounds the air of urgency. There are only a few days left to act: then Congress may be gone until next year, which could be too late But a large infusion of cash continues to be out of the a mrge measure of cash continues to be out of the question. The administration remains opposed on both philosophical and facal grounds, while many in Congress thank too much is being spent on farmers already. And the money isn't there anyway, given the size of the deficit.

So the bill would report essentially to accounting tricks. The system would be permutted to refinance and stretch out its debt to the money markets. Member banks would also be allowed 20 years to write off bad loans, instead of having 19 he now there out the administrators may not be the to shift assets among member benks as easily as the bill supposed. In theory this power has been rarely if ever worked. Prospering farmers and banks in one to the supposed of the supposed Though the system of accountancy would no longer acknowledge it, the member banks with not. Prospering termers and users in one inough the system or accounted to thinking of them in are not accustomed to thinking of them in as the guarantors of the debt of less too many non-performing loses would still lack mante brethren nomewhere eine. They say the resources to meet their obligations—"lack in ag policy is neither seasible—they could be chickens," a congressional side called them the

Conferees Agree to Include Provision On Farm Credit System in Deficit Bill

WASHINGTON-Legislation to be the secondly described Fairy Cred. Secret tage to accounting seconds or it can seed supplies. When seed these their seed supplies.

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Jouse Votes Farm Credit Bill Designed To Delay Need for Any Bailout by U.S.

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MASHINGTON - The House approved a bill designed to postpone any need to in-luse teerar hands mie the struggling Farm Credi: System

Credit System.

The measure passed on a voice voice, would permit the huge farm cooperative leading system to shed its high-interest deci over 20 years while changing its accounting methods to street out the counting services of this transaction and its insir-loss ar-

or usal transaction, and its loan-loss ac-counting The accounting changes would make routibuing Farm Credit losses. But the changes would mean that cer-tair. Farm: Credit linancial reports wouldn't automatically trigger a request for Treasum, linancing for the system's weaker-based.

weaker banks

weaker maint.
The registator drew immediate criti-cism. from the head of Congress a General Accounting Politics. Comproving "enteral Charles Sowsher said." The legislation Could improve the speec of reforms of the managerian practices and operations of the Farm. Credit: System that were contem-plated by the Congress.

Two Congressional Tracks

plates by the Congress

Two Congressional Tracks

The Farm Creat but is on two tracks in Congress House-Senate conterees have meeted a marrowing the federal orders into a but, aurocc at narrowing the federal orders as much as 15 bullon in the provision is subject to chaterine on the Senate floor, but is the House-law makers will one only on the entire of the intermediation but.

Rep. Ed. Jones (D., Tean -, chairman of the Mouse Agriculture Committee). Committee is Compressed and Credit indeministees. Some investigation and Credit indeministees. And the but is Congress is best opportunity to Theory the Agriculture Committees. And the but is Congress is best opportunity. And Rep. Das. Gactuman 'D. Kan, a committee member, said that without the legislation. The system might fail by year's eac. Mr. Gickiman, who acknowledged the buff contains provisional before 'I bits said. "It's procupity better than doing nothing.

Craig Summons, the GAO's expert on the Farm Credit System agreed that the second of a federal rescue her macher 25 years. The berges them isolate president with the accounting switch would put off the need for a federal rescue her macher 25 years. The berges them isolate president will have a scanbe producting an uniproved. The summons and the system magnitude well have a scanbe producting an uniprovent it the system's fauncial health, he said. "We re kidding ourse view."

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It's billion.

Mr. Bowsher, is a letter to House Agriculture Communier Chairman Kild, see in Garra, 10. Texas, and Senate Agriculture Communier Chairman Feath Herman R., N.C., and the legislation reade hise "the very serious hugaria, problems that the system will represence in the future. He warried that the place rould overstate the system searming to \$5 to billion or more over the sext. 21, years. In other, the legislation, may turn the close back to the earlier era of undisciplined accounting practices and some credit analyses and approva... In page.

proval. He said.

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FOURTH PRESSUR CARD.

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that "could temp the system down. Mr Summons said.

Such a rejection would be viewed as a agnal to silvestors in Farm Credit bonds that the government has soon interest in keeping the system alive. Mr Summons adoor, The implice federal support for the PYMEM. In what has kept its notes and bonds viable with that undertending "If over 1 matter bow insoftent, the systemment be the GAO official said.

All' Summons adoor that the GAO use figures the Farm Credit hands while native to but a See Bolling premium, to be a fairly.

IC Day a Self billion premium, he be among the over 25 years, to nomens of SM billion the high-cost dept for the banas is to substitute that dept with new bunds at our rent. lower interest rates it seeking the new leaststation, system knowns said the would much a \$25 billion premium.

Senate Approves Measure to Extend CFTC for 6 Years

By ALFRET M. BARE
BRAFF RESERVED OF THE SERVED DOUBLES AND BRAFF BEFORE A BILL TO COMMONITY PROCESS OF THE COMMONITY PROCESS Trading Community

for six years.
The Sensie voted 65-1 for CFTC reautierization to keep the agency institutioning through kept. Mr. 1982. Differences between the Senate measure and a similar bill the House recently passed must be resolved in a joint conference.

a joint conference.

A Rapin difference involves provisions for "leverage trading," under which sives fore, using a small down purposen, states leaguest contracts to large or sell precious nectus of of humes exchanges.

The Senate bill would end CPTC regulation of the two forms currently engaged in differentiage leverage trading, thus forcing trades onto exchanges of setting states regulate the trading. The House measurement of the contracts of the contract in the part CPTC officials concerned in the contract.

comes offer the contracts to the put.

CTIC officials concerned that concerns might adjourn this month without results, runge to agency, had loobers for passage of the ball. But the Senate action was term-

poraris delayed as some ser iters unsur-cessfully attempted to tack on farm-hy-gram amendments. Before approxing the measure the Ser

are added some other interies amend ments. One would require stiffer froets, requirements for the quality of exported grair. Some countries recently had com-plained about the grain's quality. Another amendment would require the congres-mental General Accounting Office to study whether trading is cattle interest underly

whether trausing is cattle INDEPES unders depresses cattle prices, as susse many cat the rancher groups has a raised Senators also approved as amendment offere to Senate Agreeature Committee Chaurman Jesse Heims (R. N.C.). The amendment would prevent any citis is in puri quotas to suzz: iron the Philippings and Caribbear Basin nations: a major 1951

see Cathorer Basin natives a major 184 barm has requires such cust for BEST-exporting countries. The amendment sales where the guern imports from any sales where the government deals is selected usual trade of slegal drugs, or from any country that buys sugar from Cubs. The U.S. doesn't allow direct sugar imports from Cabs.

trom Caba.

The Sennie recently approved the same sugar procusions as part or a major anti-drug bill.

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United States General Accounting Office

Briefing Report to Selected Members of Congress

1967

THRIFT INDUSTRY

The Treasury/Federal Home Loan Bank Board Plan for FSLIC Recapitalization



Printed copies of this report are in production and will be available shortly.

GGD-87-46BR



United States General Accounting Office Washington, D.C. 20648

General Government Division

B-226353

March 3, 1987

The Honorable Pernand J. St Germain Chairman, Committee on Banking, Finance and Urban Affairs House of Representatives

The Honorable William Proxmire Chairman, Committee on Banking, Housing and Urban Affairs United States Senate

This report discusses the need for a recapitalization of the Federal Savings and Loan Insurance Corporation (FSLIC). As you requested, we are providing you the results of our study on recapitalization and, more specifically, our analysis of the recapitalization plan first proposed jointly by the U.S. Treasury and the Federal Home Loan Bank Board (FHLBB) in mid-1986. FSLIC, which insures the safety of savings in thrifts and home-financing institutions and plays an important role in sustaining public confidence in the soundness of the U.S. financial system, is in urgent need of additional funds. At issue is FSLIC's ability to deal effectively with a backlog of troubled FSLIC-insured institutions.

In combination with problematic conditions in the thrift industry, FSLIC's current financial weakness is troubling. The Chairman of the Pederal Bome Loan Bank Board has stated that FSLIC's primary reserves have fallen below \$2 billion. Moreover, preliminary results of our audit of FSLIC's 1986 financial condition suggest that after necessary additions to the insurance fund's reserve for contingent liabilities, FSLIC may have a negative net worth of more than \$3 billion. Clearly, it will be extremely difficult, if not impossible, for the fund to handle the industry problems it faces under these conditions.

The thrift industry's 3,234 institutions have total assets of more than \$1.1 trillion and deposits exceeding \$900 billion. As of the third quarter of 1986, there were 445 operating thrift institutions that were

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insolvent under generally accepted accounting principles (GAAP). These insolvent institutions held \$112.7 billion in assets and were losing money at the rate of over \$5 billion a year. The FHLBB has estimated the current cost to FSLIC of resolving already recognized problem institutions at \$23.5 billion.

Quick and decisive action is needed if FSLIC is to protect itself from even greater losses in the future. Unfortunately, the condition of FSLIC's reserves virtually precludes its taking any action at the present time. Against this background there has been much discussion in the industry, Congress, and the press about the need to strengthen FSLIC and to recapitalize the insurance fund.

The Treasury and FHLBB have presented to Congress a proposal that would provide approximately \$25 billion over 5 years for case resolutions by FSLIC--\$15 billion borrowed from the capital markets and about \$10 billion from various sources of FSLIC income. The borrowing would be done by a Financing Corporation (FC), funded by a \$3 billion contribution from the Federal Home Loan District Banks This contribution would be used to purchase zero coupon bonds in amounts and maturities to guarantee repayment of the principal of the FC's borrowings. The debt service would be paid by all FSLIC-insured institutions through a dollar-for-dollar reallocation to the FC of their FSLIC insurance premium payments.

Officials at Treasury have said that two primary determinants of the recapitalization plan's structure were (1) the plan had to be financed by the industry and (2) there should be no effect on the federal budget deficit. Elimination of one or both of these two criteria would expand the financing options available to rescue FSLIC. For example, it would be simpler and less expensive if FSLIC were to borrow the needed funds directly from Treasury, and rely on industry financing to repay the loan through a combination of a \$3 billion contribution from the FHLBanks and a redirection of a portion of FSLIC's future income stream. Such a plan, however, would increase the budget deficit by \$15 billion as the money was spent to resolve FSLIC cases.

In this report, we examine the Treasury/FHLBB plan's ability to make available to FSLIC the full \$25 billion proposed. We also discuss some of the costs and benefits

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of adopting this plan. In order to test the plan's feasibility, we developed a model that allowed us to simulate its operations under a variety of assumptions about conditions in the economy and the industry.

Our model suggests that the FC should be able to borrow the proposed \$15 billion, given reasonable assumptions about interest rates and, given an assumption that the industry does not deteriorate significantly over the plan's 5-year period. However, the full \$10 billion that is to be made available from FSLIC's normal receipts can only be achieved if there is income beyond that derived from regular insurance premiums and from investment income earned on the insurance fund's assets.

FSLIC expects to receive a substantial cash flow from the sale of assets acquired through the liquidation or merger of failed institutions. The Federal Asset Disposition Association (FADA) was created by FSLIC for the purpose of managing and disposing of these assets. However, if the cash flow from the sale of nonperforming assets does not materialize or if it is insufficient, it may be necessary to continue collecting all or part of the special insurance assessment currently paid by FSLIC-insured institutions in addition to their regular premium. With sufficient additional FSLIC income from entitle of these sources, the Treasury/FHLBB plan can provide the full \$25 billion for FSLIC case resolutions over the 5-year period.

Provision of a large sum of money in a fairly short period is the greatest advantage of the proposal. With these funds, FSLIC should be able to deal with many problem institutions that are now, of necessity, being ignored. By doing so, FSLIC should reduce future costs, both for the industry and for the insurance fund.

The recapitalization proposal does, however, have a major cost attached. The true measure of this cost may not be in money terms, but in reduced flexibility for FSLIC in the years after the 5-year plan is completed. By borrowing a large sum of money for the resolution of current problems, the plan capitalizes FSLIC's future income stream in much the same way that an individual can capitalize his future earnings in order to get enough money now to buy a house.

Borrowing now, however, means less money will be available later for FSLIC needs. In fact, several of our simulations show that virtually all regular premium

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income will be needed to pay the debt service on the FC's borrowings by the end of the 5-year plan and for some years beyond. This suggests that after the \$25 billion has been spent FSLIC s ability to deal with problems that have not yet surfaced or, indeed, with those currently identified if their resolution costs are understated, will be severely constrained. We do not, in this report, address the question of whether \$25 billion is enough to solve the problems facing FSLIC. The recapitalization plan will not, however, leave FSLIC with many resources to meet additional demands once the \$25 billion has been spent.

We have performed financial audits of PSLIC, conducted evaluations of the financial condition of the industry, and studied the implications for market structure and risk of the deregulation of depository institutions for a number of years. On the basis of that work we would like to offer the following observations on actions that need to be considered in conjunction with recapitalizing PSLIC to better assure that the problems of the past do not repeat themselves.

Pirst, we believe that the Treasury/FHLBB plan as presented does not include sufficient oversight by Congress. Any plan for FSLIC recapitalization finally accepted by Congress should include provisions for oversight of both the plans and the actions of the FHLBB and the FSLIC to ensure that the funds are being effectively and appropriately spent.

Purthermore, to better ensure that problems similar to those now existing in the industry and PSLIC do not recur in the future, close examination and supervision is essential to detect and control as early as possible both fraud and regulatory noncompliance. In this regard, it may also be helpful to reexamine the Bank Board's regulations to ensure that speculative and risky activities not appropriate or desirable for institutions with federal deposit insurance are prohibited. Moreover, as the backlog of PSLIC problems is reduced, it may be advisable to reexamine the policy determining when PSLIC action should be initiated to close problem institutions. To the extent that institutions engage in excessively risky activities because they are insolvent and have nothing to lose, earlier PSLIC actions may reduce the incidence of such behavior and the resulting cost to the insurance fund.

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Most of the thrifts now receiving FSLIC attention have serious asset quality problems. To a large extent, these bad assets are likely to be the end result of risky and speculative actions by the failing institutions. What is unclear from the evidence available to us is the sequence of the relationship between the firm's activities and its financial condition. That is, we do not know if the thrifts became insolvent and then engaged in high risk activities in an attempt to return to profitability and positive net worth, or whether healthy institutions engaged in risky activities and the losers became insolvent. It may be that both situations are occurring simultaneously in the industry. While the policy prescriptions for these two scenarios are quite different, the regulatory actions suggested above would work to control both.

The Treasury and the Bank Board have seen this report, although at the request of the Chairman of the House Committee on Banking, Finance and Urban Affairs we did not obtain their official comments in order that the report could be made available more quickly. Neither Treasury nor the Bank Board had any substantive disagreements with the report.

Copies of this report will be distributed to interested parties. Any questions you may have can be addressed to me at (202) 275-6059 or Craig Simmons at (202) 275-8678.

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William J. Anderson Assistant Comptroller General

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ABBREVIATIONS

CBO	Congressional Budget Office
FADA	Federal Asset Disposition Association
FC	Pinancing Corporation
FDIC	Federal Deposit Insurance Corporation
FHLBank	Federal Home Loan Bank
PHLBB	Federal Home Loan Bank Board
FSLIC	Federal Savings and Loan Insurance Corporation
MCP	Management Consignment Program
OMB	Office of Management and Budget

THE FSLIC RECAPITALIZATION PLAN

In mid-1986 the Federal Home Loan Bank Board (FHLBB) and the U.S. Treasury presented a plan to Congress that was designed to provide additional reserves to the Federal Savings and Loan Insurance Corporation (FSLIC). This has come to be known as FSLIC recapitalization. The Bank Board has estimated that FSLIC needs \$23.5 billion or more in order to deal with the known problems in the thrift industry. In testimony before the House Banking Committee on January 21, 1987, the Chairman of the FHLBB (Testimony, House Banking Committee, 1/21/87) indicated that the primary reserves of the insurance fund were only \$1.9 billion at that time.

The Treasury/FHLBB plan passed both houses of Congress last year in two somewhat different versions but was not adopted into law because of controversial and unrelated amendments. It was resubmitted in the 1987 session, and hearings on the issue are continuing in the Bouse and Senate Banking Committees.

The proposed recapitalization plan attempts to satisfy several objectives. Primarily:

- -- the plan is to be industry financed, requiring no additional federal contribution, i.e., from the Treasury,
- --FSLIC expenditures from the recapitalized fund are not to contribute to an increase in the federal budget deficit, and
- -- the plan needs to raise sufficient funds to deal with the known industry problems.

PSLIC recapitalization attempts to satisfy these objectives by combining FSLIC income from insurance premiums and investments, substantial contributions of money from the Federal Home Loan Banks (FHLBanks), and long-term borrowing in the capital markets in order to raise \$25 to \$30 billion over 5 years. In effect, the plan is designed to capitalize FSLIC's future earnings stream, providing funds needed now that will enable FSLIC to deal quickly with the most immediate problems in the industry, thereby arresting its exposure to future losses from its covered caseload.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Treasury/FHLBB plan does appear to satisfy the first two objectives, requiring no public funds and being neutral in its budget effect. Our primary focus in this report, therefore, is on whether the plan can realistically provide as much money as it proposes. We do not here address the question of whether \$25 billion is a reasonable estimate of what is needed to deal with the industry's problem. However, on the basis of our previous

work and our knowledge of the condition of the industry, we do not believe that \$25 billion overstates the extent of the problem facing FSLIC.

Our objective was to examine the FSLIC recapitalization plan and to test its ability to raise the contemplated \$25 billion over 5 years for the insurance fund. We used a computer simulation model to test the sensitivity of the plan to changes in economic assumptions about interest rates, the growth of insured deposits and the availability of additional sources of income to FSLIC. Alternative scenarios were tested individually and in various combinations to evaluate the conditions under which the recapitalization plan could be expected to work. (A detailed discussion of the simulations and their results is presented in app. III.)

Information used in our analysis was collected from a number of sources. Data on the condition of the industry in the third quarter of 1986 were extracted from our data base of industry financial statements. These data are provided to us by the Bank Board from quarterly reports filed by thrift institutions with the FHLBB. We have not verified the data provided by the Bank Board. Any errors that may have occurred in the preparation of the financial statements or their transcription to computerized data files have not been corrected by us. We have discussed the recapitalization plan and the condition of the industry with officials at the Treasury, FHLBB, and FSLIC.

THE MECHANISM OF FSLIC RECAPITALIZATION

Crucial to the workings of the recapitalization plan is the Financing Corporation (FC). The FC would be created by the legislation to act as the intermediary between the Federal Home Loan Banks and FSLIC and between the capital markets and the FSLIC-insured thrifts.

The FHLBanks' contribution to recapitalization

As proposed in the legislation, FSLIC recapitalization begins with a contribution by the Federal Home Loan Banks to the FC of up to \$3 billion over a 5-year period. This money would be taken from the legal reserve of the FHLBanks, with each Bank contributing approximately its pro rata share based on the total volume of industry deposits held by the FSLIC-insured members in its district.

Most of the reserves of the FHLBank system are comprised of the paid-in stock of the member institutions. The Banks are required, in addition, to set aside 20 percent of each year's net income in a legal reserve. The FHLBank contribution to the FC is to be taken only from the accumulated funds in the legal reserve.

At the end of 1986, FHLBank funds available for contribution from the legal reserve to the FC totaled about \$2.2 billion, up from \$1.8 billion at the end of 1985. The Treasury and the Bank Board believe that the FHLBanks could relinquish these funds, together with future retained earnings up to a total of \$3 billion, without prejudicing the stability of the FHLBank system. As a result, they believe that contributing to the FC would not raise the costs associated with the FHLBanks' regular borrowing activity.

The FC will then borrow up to \$15 billion by selling long-term bonds with maturities of 20 to 30 years. These borrowings are also to take place over 5 years with approximately equal amounts to be borrowed each year. The proceeds will be given to FSLIC to use for resolving problem institutions in the industry. In return, FSLIC will give the FC up to \$3 billion in non-voting capital stock (equal to the FHLBanks' contribution to the FC) together with non-redeemable capital certificates in exchange for the remainder of the funds received.

Over 5 years, initial cash transfers involved in the plan to provide additional money for FSLIC can be summarized as follows:

PHLBanks Financing Corp.

FSLIC

-3 billion to FC

+\$3 billion from FHLBanks

+\$15 billion from FC

+\$15 billion from borrowing

-\$15 billion to FSLIC

As a result, FSLIC will have over the next 5 years \$15 billion in funds that were not previously available to use for case resolutions. At the same time, the FC has \$3 billion left from its total cash inflow of \$18 billion. This \$3 billion is an important element in the repayment mechanism, as will be discussed later in this appendix.

The FSLIC contribution to recapitalization

Under the recapitalization plan as proposed, FSLIC would receive an average of \$3 billion per year for 5 years from the FC. Both FHLBB and Treasury say that the plan can provide up to \$25 billion or more for FSLIC case resolution. The additional \$10 billion, or \$2 billion per year for 5 years, is to come from FSLIC income. There are three primary sources of income to

FSLIC--insurance premiums assessed on insured institutions, ¹ investment income from earning assets held as reserves, and revenues realized from the sale of nonperforming assets acquired through the merger or liquidation of failed institutions.

FSLIC is authorized to charge a regular insurance premium equal to one-twelfth of 1 percent of the deposits of insured institutions. In addition to the regular premium, FSLIC can also charge special premiums which may not exceed one-eighth of 1 percent of total deposits in any year. Such special assessments have been levied for the last 2 years. Part of the recapitalization plan presented last year to Congress would involve a phase-out of the special assessment over a 5-year period from 1988 through 1992, unless the Bank Board determines that severe pressures on FSLIC necessitate its continuation.

FSLIC also earns investment income on its reserves. At the end of 1986, FSLIC had about \$3.8 billion in earning assets. This amount was, however down from \$6.1 billion at the end of 1985. Given the need for FSLIC to maintain liquidity and avoid risk, these assets can be expected to earn at rates comparable to those on short-term Treasury securities.

Finally, FSLIC should realize some cash flow from the sale of nonperforming assets acquired through the liquidation and merger of failed institutions. At the end of 1986, FSLIC held claims against assets held in receiverships totaling about \$12 billion. Currently, it is estimated that only about \$5 billion, or 42 percent, will ultimately be collected.

Hoping to improve on this performance, the Bank Board, in November 1985, chartered a wholly-owned association under section 406 of the National Housing Act for the purpose of managing and, ultimately, disposing of nonperforming assets held in FSLIC receiverships. This organization, known as the Federal Asset Disposition Association FADA, was capitalized by FSLIC with \$25 million and by the end of 1986 was responsible for managing approximately \$3 billion in nonperforming assets. Money realized from the sale of acquired assets could provide an important future source of cash for the FSLIC fund. However, the actual level of expected receipts from asset realizations is difficult to predict.

The actual amount of income FSLIC will receive from premiums depends on the FC's debt service payments that are to be deducted from premium income and on the growth rate of insured deposits. If deposits don't grow, for example, because healthy institutions convert to FDIC insurance, then FSLIC's future premium income will not grow.

Repayment

It is expected that the extra \$3 billion held by the FC above its contribution to FSLIC will provide the basis for the repayment of the FC's debt, as well as the necessary security to enable the FC to borrow at low rates in the capital markets. As the FC borrows, it will use the extra money to purchase zero coupon bonds in maturities matching those of its borrowings, and in denominations such that at maturity the face value plus accrued interest will exactly pay off the total principal due on the debt. At present it is envisioned that up to \$2.2 billion of the FHLBanks' contribution will be spent in this fashion. Thus, the FC's repayment of principal is guaranteed by the matching zero coupon bond purchased at the same time the money is borrowed. This repayment of principal would be the responsibility of the FC and would not be insured by FSLIC or the Bank Board. The legislation as proposed states that neither the principal amount nor the interest costs on the FC's obligations would be backed by the full faith and credit of the United States

The debt service, or interest, on the FC's borrowing was originally intended to be paid by FSLIC out of its premium income. The Congressional Budget Office (CBO) pointed out that this arrangement would result in budget outlays. Therefore, a provision was added to the legislative proposal that, in effect, permits FSLIC-insured institutions to pay part or all of their premiums directly to the FC. The institutions' premiums and any special assessments that would regularly be paid to FSLIC are reduced dollar-for-dollar by the increased debt service requirements of the FC. Moreover, the \$800 million that remains from the original \$3 billion contribution by the FHLBanks is intended as a cushion to be used for debt service or other related costs of the FC.2

As envisioned in the Treasury/FHLBB proposal, both the principal and interest on the FC's debt would be paid with no explicit or implied guarantee from either FSLIC or the U.S. Treasury. However, as noted above, up to 100 percent of FSLIC's insurance premium income could be diverted to pay interest on the FC's debt until the principal is repaid, somewhere around 2020. Such diversion of premium income, however, means that FSLIC would have little income for case resolutions after the \$25 billion raised through the 5-year recapitalization plan is spent.

The \$800 million could also become available to leverage additional borrowing by the FC if permitted by legislation, possibly increasing the potential borrowing above \$15 billion. This would, however, also increase the debt servicing burden and further reduce PSLIC's future stream of income.

APPENDIX I

APPENDIX I

When the entire FC debt is paid off, FSLIC may retire its outstanding capital stock together with a return on that stock, if the condition of the FSLIC insurance fund permits. In other words, repayment of the original \$3 billion provided by the FHLBanks to the FC would occur only after all other debt was paid off and only if the reserve-to-deposit ratio of the insurance fund was adequate. It is possible that this money would never be repaid to the FHLBanks.

APPENDIX II

APPENDIX II

AN ANALYSIS OF THE TREASURY/FHLBB PROPOSAL TO RECAPITALIZE FSLIC

There is an urgent need to provide additional funds to FSLIC in order to deal with the current backlog of problem institutions For several years the Federal Home Loan Bank Board, which operates FSLIC, has delayed finding merger partners or liquidating institutions with capital adequacy problems. Instead, FSLIC has relaxed accounting standards engaged in implicit forebearance on capital requirements, provided artificial forms of regulatory capital and operated institutions under the Management Consignment Program (MCP).

Despite these efforts, the number of institutions with serious problems, which we have defined as having GAAP net worth equal to or less than zero, increased sharply from only 16 in December 1980 to 461 thrifts holding \$112.6 billion in assets in mid-1985. By September 1986 there were still 445 insolvent thrifts with \$112.7 billion in assets operating under the PSLIC insurance guarantee. These insolvent thrifts had an average (annualized) return on assets of -5.0 percent in the third quarter of 1986. They comprised 13.8 percent of the industry and held 10.1 percent of the industry's assets.

In recent testimony before the Senate Committee on Banking, Bousing and Orban Affairs on January 21, 1987, (p. 3), the Chairman of the FHLBB estimated the cost of resolving the industry's known problems at \$23.5 billion. At that time 347 institutions were included in the "significant supervisory caseload" and 167 of these thrifts were FSLIC cases. Moreover, these 347 institutions were losing \$6 million a day or \$2.2 billion a year. This amount, as the Chairman pointed out, is larger than the entire 1986 income to FSLIC.

THE COST OF DELAY

The size of the problems facing FSLIC ensures that case resolutions will have to be accomplished over time rather than all at once. Even if enough money were available to handle all

¹MCPs are institutions for which FSLIC has hired new contract managers after removing the original management.

²Those institutions included in the "significant supervisory caseload" are receiving extraordinary attention from the examination and supervisory staff in the District Banks. FSLIC cases are those whose problems are so severe that the insurance corporation is attempting to find a resolution, either a merger partner or a liquidation.

problems at once, other resources, such as staff, limit the speed at which FSLIC could proceed. The risk is that delay, even necessary delay, could lead to an increase in FSLIC's ultimate resolution cost. Our earlier work showed the potential for FSLIC savings due to reductions in interest rates and also pointed out the large potential costs that could result from the effect of rising rates and declining loan values (GAO/GGD-86-122BR).

FSLIC's resolution costs may rise for other reasons, such as bad management or fraud and the resulting increase in bad assets. Some losses in a failing thrift will have already occurred, even though they may not yet be recognized on the books. Other losses may be unavoidable given the structure and composition of the failing institution's balance sheet. These losses will not be averted by FSLIC action. They will affect the receivership just as they would have affected the operating thrift. What FSLIC action can end is the continuation of incompetent or fraudulent management and resulting future losses for the institution. This can be accomplished through the sale of the thrift to a healthy institution that will replace the management or through the establishment of a receivership. The elimination of bad management may, in fact, be the major reason that prompt action by FSLIC can lead to cost savings for the insurance fund.

The Bank Board has said that the majority of current cases requiring FSLIC action result from asset quality problems rather than from the interest-rate spread problems of the early 1980's. Asset quality problems are potentially much more costly to the insurance fund than are spread problems. A thrift with a negative interest-rate spread, i.e., its cost of funds exceeds the average return on its loans, can continue in operation for a substantial period while experiencing only a gradual erosion of its regulatory capital or net worth. This is because institutions are not required by regulators to use market values for the assets in their portfolios. To be sure, if forced to sell assets during an inflationary period, a thrift would experience large, immediate losses potentially affecting its entire portfolio. Nevertheless, with an appropriate discount to reflect the inflationary adjustment, the assets are still marketable.

The long-term severity of spread problems is mitigated by their inherently cyclical nature. Problems traceable to rising inflation and interest rates are diminished with reductions in these same inflation and interest rates. Also, spread problems do not necessarily mean that problems exist with either the repayment capacity of the borrower or with the collateral on the loan. This is the primary justification for FSLIC's provision of forebearance to institutions with spread problems, as was the case in the thrift industry of the early 1980's.

Problems with asset quality can be much more difficult to deal with than those associated with interest rate risk and negative spreads. A single large asset that goes bad can immediately wipe out an institution's entire net worth with little or no warning outside the firm. When an asset goes bad, the income from debt service payments may cease and realizations from liquidation of the underlying collateral may yield far less than 100 cents on the dollar. Moreover, in contrast to spread problems' improvement with falling inflation, there is much less likelihood of recovery from asset quality problems. We are told by officials at FSLIC and the Bank Board that, in general, problems of asset quality are both less predictable and more costly to the insurance fund than are spread problems. Forebearance, or delay, is much less likely to be helpful to an institution with credit risk and bad assets.

Spread problems are not necessarily a thing of the past. While there is, at present, no indication of rising interest rates in the near future, the thrift industry is nevertheless becoming increasingly exposed to potential losses when interest rates do eventually rise. Today's low interest rate environment has led many thrifts to substantially increase their origination of relatively low-yield, fixed-rate mortgages, both for new loans and refinancings. Adjustable rate mortgages as a percentage of conventional home mortgages closed have fallen from a peak of 73 percent in mid-1984 to about 30 percent in mid-1986. Some of these fixed-rate mortgages are being packaged for resale as mortgage-backed securities in the secondary market rather than held in the thrift's portfolios. Nevertheless, a rise in interest rates would cause many institutions with increasing holdings of these fixed-rate mortgages to encounter problems similar to those experienced a few years ago. This time, however, the industry does not have the net worth that allowed many firms to weather the last increase in interest rates. Industry net worth (GAAP) as a percent of assets was only 3.4 percent in June 1986, as compared with 5.73 percent in mid-1978.

Finally, delay has two other immediate and obvious costs. Every dollar of continuing losses by an insolvent thrift represents an additional cost to FSLIC when the institution is finally resolved. Moreover, the FHLBB has said that insolvent thrifts are offering higher than market rates in order to attract deposits, thus bidding up rates, not only for themselves, but for the healthier institutions as well. This raises the cost of funds for the whole industry and results in slimmer profit margins (or larger losses) for all institutions.

THE TREASURY/FHLBB RECAPITALIZATION PROPOSAL

The joint Treasury/FHLBB proposal to recapitalize FSLIC has the virtue of providing a large sum of money to FSLIC over a

fairly short period of time. Given the extent of the industry's problems and the risks of delay, we feel that the capitalization of future FSLIC earnings is necessary. We therefore modeled the proposed recapitalization plan to see if it could achieve its stated objectives. Success was defined as the ability to provide \$25 billion for FSLIC case resolutions over a 5-year period without reducing FSLIC's earning assets to zero.

Of the \$25 billion, \$15 billion (or \$3 billion a year) is to be raised by selling bonds through the FC. The remaining \$10 billion (or \$2 billion per year) is to be derived from other sources of FSLIC income. FSLIC's sources of income are:

- --regular premium income (1/12 of 1 percent of insured deposits),
- --special premium income (1/8 of 1 percent of insured deposits),
- --investment income derived from the earning assets held by FSLIC, and
- --cash flow from the disposition of assets acquired by FSLIC through the liquidation or merger of failed thrifts.

Details on the various alternative scenarios that we simulated in modeling the recapitalization plan are found in appendix III. Briefly we tested the sensitivity of the model to different assumptions about the levels of interest rates and spreads and to alternative rates of deposit growth. We also varied the dollar amounts received by FSLIC from the sale of distressed assets acquired through case resolutions, and the future availability of income from the special premium assessment. The successful simulations were then examined under different assumptions about changes in the level of interest rates (i.e., increasing or decreasing) over time.

Several conclusions can be drawn from the simulations that we performed.

- --The FSLIC recapitalization plan is relatively unaffected by variations in the economic environment.
- --With reasonable assumptions about the interest rates that would prevail on the FC borrowings and on the zero coupon bonds that are to be purchased, there should be little difficulty in raising the \$15 billion dollars to be contributed by the FC.
- --The appropriate use of zero coupon bonds ensures the repayment of principal on the FC's borrowings.

--The debt service on the FC's borrowing would absorb essentially 100 percent or more of the FSLIC's premium income for several years unless the special assessment were to be continued.

- --Income to FSLIC from insurance premiums and from investing its earning assets is not sufficient to provide the full \$10 billion that is FSLIC's share of the recapitalization plan. The shortfall might possibly be made up by receipts from the sale of assets acquired by FSLIC or by a continuation of all or part of the special assessment.
- --Even under most of the "successful" scenarios, the earning assets of the FSLIC fund are small during years 6 through 10.

In other words, the FSLIC recapitalization plan will provide \$15 billion over 5 years to the insurance fund from borrowing, and an additional \$10 billion can be made available from FSLIC income. However, the full \$ 0 billion will be there only if sufficient extra income, either from the sale of acquired assets or from the continuation of all or part of the special assessment, is forthcoming. Even if enough extra income is not generated, the plan will still provide a substantial amount of money to FSLIC--in excess of \$21 to \$24 billion over the 5-year period. The major drawback of the plan is the diversion of virtually all regular future insurance premium income to pay debt service, which will seriously reduce the ability of FSLIC to address future problems.

CONCLUSIONS

There is a serious need for additional money to be used by FSLIC for the purpose of resolving the large backlog of insolvent and unprofitable institutions that continue to operate in the thrift industry. While the exact size of the problem and, more importantly, the exact cost of dealing with the problem cannot be known with certainty, the Bank Board's estimate in January of this year of the cost to resolve the known problems was \$23.5 billion or more.

Our simulations show that the Treasury/FHLBB proposal can raise \$25 billion over 5 years as long as the flow of income to FSLIC is augmented either by continuing the special premium assessment or by receipts from the sale of assets acquired through the liquidation process. However, if the proposal is implemented, it is probable that virtually all of FSLIC's regular premium income will be diverted to pay the debt service for several years. As a result, assuming that all \$25 billion is spent in the next 5 years, there may not be much available to deal with later problems.

Some specific issues should be dealt with in setting up a FSLIC recapitalization plan.

- --Congressional review and oversight of the plans and actions of the Bank Board and FSLIC should be included in the legislation. Oversight should be designed to seek answers to questions regarding FSLIC's plans for use of the proceeds from recapitalization as well as how successful the problem resolution process is.
- --Provision for some control mechanism in the event that the oversight process results in negative findings.

Finally, unless Congress comes to grips with the causes of the industry's current problems, there is every likelihood that they will continue to occur in the future. If the causes are not effectively dealt with now, the \$25 billion to be raised under the FSLIC recapitalization may solve today's crises but will provide nothing to resolve tomorrow's. Therefore, the deliberations over FSLIC recapitalization provide the opportunity to require the FHLBB and FSLIC to reorganize and streamline their operations and regulatory structure with the intent of reducing the likelihood of future industrywide problems such as those now occurring.

ASSUMPTIONS AND SIMULATION RESULTS OF THE FSLIC RECAPITALIZATION MODEL

We developed a model of the FSLIC recapitalization proposal in order to test the effect of variations in the proposal as well as the effect of changes in various economic assumptions. The assumptions used to model the plan as it has been outlined by the Treasury and the Federal Home Loan Bank Board (what we term the "base model") are given below, along with a description of those assumptions that were allowed to vary. Use of the model allowed to investigate the conditions under which the plan may or may not be successful.

ASSUMPTIONS OF THE BASE MODEL

The following assumptions were used in developing the base ${\bf x}{\bf x}{\bf z}{\bf c}{\bf d}{\bf c}$

--The Financing Corporation raises \$3 billion a year for each of the 5 years of the plan by issuing fixed-rate 30-year bonds. It uses as leverage the retained earnings of the Federal Home Loan Banks in the amount of \$440 million each year (a total of \$2.2 billion over 5 years). With these funds it purchases zero coupon bonds whose maturities and

In our simulations we assumed that all borrowings of the FC were accomplished by issuing 30-year bonds. The Treasury/FHLBB proposal actually calls for an unspecified mix of 20- and 30-year bonds. We used the longer-term issue rather than make an assumption about the mix for several reasons. Most importantly, the market is much stronger for 30-year bonds than for 20's. The Treasury/FHLBB proposal creates a new untried debt security that would have greater acceptance in the stronger market. In any case, for a given amount of borrowing, the annual interest cost is likely to be about the same for either borrowing term. The major differences are that with 30-year bonds it is possible to borrow a larger total based on a given amount of initial capital and, of course, the financing costs continue for an additional 10 years.

principal match those of the FC's own debt and whose proceeds will be used to repay this debt upon maturity.2

- --Up to \$800 million (in addition to the \$2.2 billion) in funds are to be made available by the FHLBanks over the 5-year period. It has been suggested that these funds provide a "cushion" to be used for debt service or other costs of the FC.
- --Interest payments on the FC's debt will be met through the direct payment to the FC of insurance premium assessments from member institutions which normally would have gone to FSLIC. Any premium payments in excess of this interest obligation will be channeled back to FSLIC.
- --The interest rate at which the FC issues its debt is 50 basis points higher than the 30-year Treasury bond rate. The base Treasury rate is 7.3 percent.
- --In addition to the \$15 billion from borrowing, FSLIC will make an additional \$2 billion per year available for case resolutions in each of the 5 years of the plan. This money is to be derived from premium income (net of debt service on the FC's borrowings, investment income on earning assets, and income from the sale of assets acquired through case resolution (assumed to be zero in the base model). If these sources of income total less than \$2 billion in a year, the shortfall is deducted from the earning assets of the insurance fund until those assets are depleted.
- --FSLIC earns at the Treasury bill rate on its earning assets. In the base model this rate is 5.5 percent.
- --The special assessment (1/8 of 1 percent of deposits) which is currently paid by member institutions to FSLIC will be subject to a straight-line phase-out over a 5-year period beginning in 1988.

The model assumes that the entire \$2.2 billion in funds from the Federal Home Loan Banks is fully used for purchase of the zero coupon bonds used to repay \$15 billion in FC debt (a leveraging ratio of 6.8 to 1). At current market rates for 30-year bonds, however, these funds could be leveraged by as much as 10 to 1. Thus, only \$1.5 needs to be used to buy zero coupon bonds to repay \$15 billion in 30 years. Therefore, \$700 million of additional funds would be available for use by the FC or by FSLIC.

- --The growth rate of insured deposits for the industry as a whole is assumed to be 8 percent per year, i.e., the average annual growth rate observed between 1984 and 1985.
- --In the base model, interest rates are assumed to remain constant throughout the period under consideration.
- --Our simulations cover a period of 10 years.

SIMULATION RESULTS

The model was run using the base model assumptions as well as various scenarios in which one or more of the base model assumptions were changed. In each of these initial simulations the level of interest rates was held constant over time. As the plan calls for raising \$25 to \$30 billion over 5 years, any case in which \$25 billion could be raised without causing FSLIC earning assets to be fully depleted is termed a success. This means that although FSLIC income in any one year may be insufficient to provide the necessary \$2 billion yearly contribution to the fund, earning assets may be tapped to make up the deficiency. Only if earning assets are completely depleted from their initial level of \$3.8 billion at the beginning of 1987 is the plan said to be unsuccessful.

Base model

According to this criterion, the base model described above was unsuccessful. Without receipts from the sale of assets acquired through case resolutions or from retention of the special premium, FSLIC's \$3.8 billion in earning assets were fully depleted before the total \$25 billion was made available. In other words, the income received by FSLIC over 5 years was inadequate, even when supplemented by \$3.8 billion from the insurance fund's earning assets, to provide \$10 billion for case resolutions.

The model was simulated using many variations on the base assumptions. Some of the different assumptions used include:

- --varying the PC's cost of borrowing from 50 basis points above the Treasury bond rate to 150 basis points,
- --increasing the rate earned on FSLIC's assets by 100 basis points, and
- --lowering the rate of deposit growth at insured institutions from 8 percent per year to 6 percent.

In each of these cases, FSLIC was unable to generate enough income to provide its \$10 billion share of the money for recapitalization before its earning assets went to zero. 3

Successful simulations

Of all cases investigated, three were found where success was attained in a constant interest rate environment. In these simulations the plan succeeded by:

- --allowing the special assessment to remain in place indefinitely,
- --allowing the special assessment to remain fully in place for 6 years and then eliminating it, or
 - --including in FSLIC's income receipts from the sale of acquired assets.

For the last case, we used the projections of FSLIC's asset realization income provided to us by the FHLBB.

Each of these successful cases was examined under three additional scenarios to see if <u>changing</u> the level of interest rates over time would cause the plan to fail. The three interest rate scenarios were:

- -- gradually rising interest rates,
- -- gradually falling interest rates, 4 and
- --explosively rising interest rates.

³In most cases the deficiency was less than \$1 billion. However, it should be noted that our model considered the insurance fund to be bankrupt when <u>earning</u> assets fell to zero. This assumes that all earning assets could be used for case resolution, ignoring the fact that FSLIC has other liabilities. According to recent testimony by the Chairman of the FHLBB, the primary reserves of the FSLIC insurance fund, i.e., the amount actually available for case resolutions, was not \$3.8 billion, but only \$1.9 billion.

⁴Under the base case in this declining interest scenario the plan was able to succeed without the retention of the special assessment or without income from asset realization in the amount projected. In table III.3 it can be seen that earning assets, although totaling only \$100 million after 5 years, do remain at a positive level and so meet the criterion for success of the plan.

Table III.1 shows the successful simulations under constant interest rates. Tables III.2 through III.4 outline the results of our simulations under the three different assumptions about changing levels of future interest rates. For comparison, the base model is also included in each interest rate scenario.

In each case, the maximum yearly interest obligation on the FC's debt that is to be paid out of premium income is reported along with the year in which the maximum occurred and the percent of total premium income which is devoted to the payment of interest in that year. Also reported for each case is the amount of total FSLIC earning assets after the first 5 years of the plan. This value is negative if the plan is not successful. That is, it shows the shortfall, or the amount still needed for the plan to have raised \$25 billion even after all earning assets were depleted.

Earning assets after 10 years are also reported in order to gauge the state of the FSLIC fund at some future point after the end of the recapitalization program. This value is calculated by assuming all \$25 billion raised by the program is spent on case resolution within the first 5 years of the program and that no further FSLIC outlays occur thereafter, apart from interest payments on the FC debt. Lastly, the years in which FSLIC net income is negative are listed. These are the years in which some portion of FSLIC earning assets must be expended in order for FSLIC to meet the requirement of contributing \$2 billion each year to reach the \$25 billion total.

The three successful cases were further analyzed by testing the effect of a smaller deposit growth rate than had been assumed in the base model. Tables III.5 and III.6 report the results of experiments in which the deposit growth rate is decreased to 4 percent assuming constant and increasing interest rates respectively. Although in each case a larger amount of earning assets must be used in order to meet the criterion of a total recapitalization of \$25 billion, the basic results are unchanged. The three cases which were found to be successful previously remain successful even under the assumption of a 4 percent deposit growth rate.

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		a I	Maximum Yearly Interest Obligation	5	FBLIC Earning Assets After 5 Years	PSLIC Farning Assets After 10 Years	Vears PSLIC Net Income is Negative
	•	(Billions §)	As Percent of Premium	Year Max. Occurs	(Billione \$)	(Billions 8)	
÷	Base Modela	1.2	196	,	dı	1.1	1 - 5
7	Special Assessment Remains Throughout	1.2	1	ĸ	2.5	1.5.1	16 1
ų.	Special Assessment Remains 6 years	1.2	*	,	2.5	6.16	1 - 5
÷	Asset Realization Income from PADA ^C	1.2	*	; ·	3.48	12.58	1 – 3, 5

Notes: The base model assumptions are:

--The initial levels of interest rates are Treasury bonds = 7.3 percent, and Treasury bills = 5.5 percent. -Interest rates are constant over the 10 year period under simulation.

—The cost of borrowing for the PC is 50 basis points over Treasury bonds.

—The interest rate earned on the earning assets of the PSLIC is equal to the Treasury bill rate.

—The rate paid on the zero-coupon bonds purchased by the PC is 8.03 percent.

—The rate of growth of insured deposits in the industry is 8 percent per year.

—The special assessment is phased out over 5 years.

-There is no income to PSLIC from the sale of assets acquired through case resolutions.

Parnings assets go to zero in year six.

Othe estimates of asset realization income are provided by the FRLMS.

Simulation Results Under Increasing Interest Rates TABLE III.2

	18 Negative	•	/ ·6	r u	c 1	Test rates are as remain constant.
PBLIC Earning Assets After	(Billione \$)	7	1 4. 8	9.	23	COUNTY Chat Inte
PGLIC Earning Assets After 5 Years	(Billions \$)	2 ,	2.4	5.4	3.38	or table 1V.1, er 3 of the plan.
S	Year Max.	^	so.	^	,	Un ame at years y and
Maximum Yearly Interest Obligation	As Percent of Premium	1051	\$	8	8	hie table are nte a years in ear eix.
1 2	(Hillions 8)	1.3	1.3	: :	?	Manual tions in the try 90 basis poly to seen in y
		1. Mana Mahaja J. Marvini Angeresses	Number Throughous	Mentine & years Asset Pentinetion	HANNE from FACA	1 - 5 second to rise by \$0 basis points table are the same as for table IV.1, encapt that interest rates are as butnings assets the plan. Therester they remain constant.
		<u>-</u> -	÷	÷		7 2

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Partitings assets 40 to send in year six.

TABLE III.3 Simulation Results Under Decreasing Interest Rates

		AB.	Maximum Yearly Interest Obligation	6	er	PSLIC Earning Assets After 10 Years	Years PSLIC Net Income is Negative
		(Billions \$)	As Percent of Premium	Year Max. Occurs	(Billions \$)	(Billions 5)	
4	1. Base Mortela	1.1	878		đ.	1.8	1 - 5
	Special Assessment Remains Throughout	1:1	\$	'n	2.6	15.80	1
e,	Special Assessment Remains 6 years	1:1	87	7	2.6	9.9	1 - 5
4	Asset Realization Income from FADA	1.1	. 68	,	3.6	12.90	1 - 3

The base model assumptions in this table are the same as for table IV.1, except that interest rates are assumed to fall by 50 basis points a year in years 2 and 3 of the plan. Thereafter they remain constant. Notes

Dearnings assets go to zero in year six.

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TABLE III.4 imulation Results (prompted by a prompted by a

Wet Income		-		s - 1	1 - 5	1 - 3, 5
FBLIC Farmin Assets After 10 Years	(Billions \$)	9	: 2		2.2	12.7
PELIC Farming PELIC Farming Assets After 15 Years 10 Years	(Billions 8)	q •-	2.3	} ;	5.5	3.28
lon	Year Max. Occurs	,	s n	•	•	•
Maximum Yearly Interest Obligation	As Percent of Premium	1221	*	133	•	ឌ
1 5	(Billions 8)	1.5	1.5	1,5		3.5
		Model &	Pecial Assessment Nameline Throughout	Special Assessment Parality 6 years	Accet Neal Isation	
		l. Base Hodel ^a	ii	11	₹	

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The base model assumption in this table are the same as for table IV.1, empty that interest rate ries by 50 basis points a year in years 2 and 3 and by 100 basis points a year in years 4 and 5. Thereafter, they remain constant.

essets are sero in years aix through ten.

TABLE 111.5

Under	ates
sults	rest R
tion Re	at Inte
Similat	Constar

Deposit Growth = 4 Percent

		AM I	Maximum Yearly Interest Obligation	8	FSLIC Earning Assets After 5 Years (Rillions S)	FBLIC Earning Assets After 10 Years (Billions S)	Years FSLIC Net Income is Negative
		(Billions \$)	As Percent of Premium	Year Max. Occurs			
ij	1. Base Modela	1.2	1258	7	1 ^b	-1.8	1 - 10
'n	Special Assessment Remains Throughout	1.2	**	, I O	1:1	8.5	1 - 5
e,	3. Special Assessment Remains 6 years	1.2	125	,	1.1	2.1	1 - 5,7-10
÷	4. Asset Realization Income from PADA	1.2	125	,	2.5	4.0	1 - 5
	-	•					

Anne base model assumptions for this table are the same as for table IV.1, except that the rate of growth of insured deposits is 4 percent per year rather than 8 percent. Notes:

Dearning assets are zero in year six.

APPENDIX III

APPENDIX III

There II.6 Similation Results Under increasing Interest Mates

Deposit Growth = 4 Percent

		A Inc	Maximum Yearly Interest Obligation	5	PELIC Earning Assets After 5 Years (Billions 8)	PGLIC Farning Assets After 10 Years (Billions \$)	Wears PHILIC Net Income is Negative
		(Billions \$)	As Percent of Premium	Year Max. Occurs			
-	Base Widel®	1.2	1364	,	-1. 2 0	-2.5	1 - 10
	Special Assessment Remains Throughout	1.2	98	w	-1	7.9	1 - 5
ë.	Special Messement Remains 6 years	1.2	138	,	7	3	1 - 5,7-10
÷	Asset Realization Income from PADA	1.2	138	. ~	7.	6.9	1 - 5

The base model assumptions for this table are the same for table IV.1, except that interest rates increase by 50 basis points a year in years 2 and 3, and the rate of deposit growth is only 4 percent per

Dearning assets are zero in year six.

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SOME ALTERNATIVE STRATEGIES FOR FSLIC RECAPITALIZATION

Several other ways of dealing with the problem of the thrift industry's insurance fund are available. These include a scaled-back version of the Treasury/FHLBB plan, merging the FSLIC and FDIC funds, and borrowing from sources other than the FHLBank system.

An inability to take action relatively quickly on FSLIC recapitalization could easily precipitate a crisis. A crisis could develop from a number of different specific causes. For example, a liquidity crisis could result from a decision by the District Banks not to grant advances to weak institutions. When advances to an institution cannot be collateralized by the institution's assets FSLIC may guarantee them, substituting its resources as the necessary collateral.

As of January 1987, there were \$2 billion of advances guaranteed by FSLIC with no collateral other than the reserves of the deposit insurance fund. At that time FSLIC's primary reserves totaled \$1.9 billion. A situation may be approaching where FHLBanks will refuse to grant advances on FSLIC's guarantee. This situation may already be occurring in California. The danger arises when the advance is needed for liquidity purposes, i.e., to meet a deposit outflow. Failure to get an advance in this circumstance could result in the inability of depositors to get their money. The thrift crises in Maryland and Ohio have shown how quickly a lack of confidence in the system leads to bank runs. This is only one example of how a crisis could result from an insurance fund with inadequate reserves.

SCALING BACK THE RECAPITALIZATION PLAN

There are many different ways in which the PSLIC recapitalization could be scaled back. One proposal suggested by the U.S. League of Savings Institutions provides for a 2-year program and slightly less money (over the 2-year period) than the Treasury/FHLBB plan. It is not our purpose in this report to analyze the U.S. League proposal; however, there seem to be three major reasons for scaling back the size of the plan:

- -- The problem may not be as large as many believe.
- --The smaller plan avoids tying up as much future income to pay the interest on borrowed money, but only if it provides enough money the first time.
- --The Bank Board is believed to require the degree of oversight and supervision implicit in having to return and

ask for more money if the need is greater than the relatively modest amount provided for in the initial program.

Given our estimates of the potential size of the problems, the first two points do not seem particularly relevant. The question of oversight is, however, an important one. Clearly, oversight is necessary whenever money is being spent in the amounts being discussed here. Not only is it necessary to ensure that the money is being used efficiently, but also appropriately. Nevertheless, a requirement that the Bank Board and FSLIC return after 2 years to explain and justify both their use of the allocated funds and their need for more may result in a substantial interim delay in resolving the problems of the industry. Furthermore, it is not clear why oversight necessarily would be less rigorous under a long-term plan. As has frequently been pointed out, delay can be quite costly.

MERGER OF FDIC AND FSLIC

A merger of the two insurance funds has been suggested as a solution to the problem now facing FSLIC. It is true that a merger might allow FDIC's reserves to be used to resolve FSLIC's problem cases. However, since FDIC s reserves are in the neighborhood of \$19 billion, and the Bank Board estimates that the cost to resolve the thrift industry's known problems could be \$20 billion or more, it is not clear how a merger could resolve the problems in both banking and the thrift industries.

Some of the resources of the FDIC could be used to assist FSLIC, if it were felt necessary, through a borrowing arrangement rather than a merger. We fail to see any benefit in actually merging the funds except where an explicit objective of the merger is to achieve consistent regulation of both the thrift and commercial banking industries and to manage the government's overall deposit insurance exposure in a more comprehensive fashion.

ALTERNATIVE SOURCES OF FUNDS

The purpose of FSLIC recapitalization is to provide additional money to the insurance fund to allow an accelerated resolution of FSLIC cases and other problems. Besides the various recapitalization proposals that have been presented recently, FSLIC and the Bank Board have access to funds from several other sources. However, each of these sources has drawbacks and, in some cases, it would be necessary to declare a crisis in order to access the funds. Moreover, in almost every case, the additional funds do not add to FSLIC's reserves since the money must be paid back, i.e., there is an offsetting liability. This appendix describes these alternative sources of funds.

Borrowing from the Treasury

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The FSLIC fund has a \$750 million line of credit available from the Treasury. The Secretary of the Treasury is authorized and directed to lend FSLIC such funds, not to exceed \$750 million in the aggregate at any one time as FHLBB judges are needed for insurance purposes (12 U.S.C. 1725(i)). These funds are not dependent upon appropriation and the Treasury may issue public debt securities to raise the necessary funds. Use of these funds by FSLIC would increase the budget deficit.

Borrowing from the Federal Reserve System

There are three authorities that could be used by FSLIC to borrow funds from the Federal Reserve System. The amount available under the following provisions depends upon the amount of suitable collateral at the disposal of FSLIC.

- --First, FSLIC may borrow funds from the Federal Reserve System under 12 U S C 347c Any Federal Reserve Bank may make advances to any corporation on its promissory notes secured by direct obligations of the United States or by any obligation fully guaranteed as to principal and interest by any agency of the United States. These advances are not to exceed 90 days, but it is presumed they are renewable.
- ---Second, under 12 U.S.C. 343, any Federal Reserve Bank may also discount notes, drafts, and bills of exchange for any corporation, but only if the Federal Reserve Board, by a vote of not less than five members determines that unusual and exigent circumstances exist. Notes drafts, and bills admitted to the discount must have a maturity of not more than 90 days.
- --Third, 12 U.S.C. 461(b)(7) provides that any depository institution in which transaction accounts or nonpersonal time deposits are held is entitled to the same discount and borrowing privileges as a member bank. In the administration of such discount and borrowing privileges, the Federal Reserve Board must take into consideration the special needs of savings and other depository institutions for access to discount and borrowing facilities consistent with their long-term asset portfolios and the sensitivity of such institutions to trends in the national money markets. A declaration of unusual and exigent circumstances is not specifically required.

FSLIC cannot borrow directly under this third authority. However, it has established a subsidary thrift institution under section 406 of the National Housing Act which is eligible to use

the Federal Reserve discount operations under this provision to the same extent as any other bank Banks may discount commercial loans or agriculture paper, and notes which are secured by residential mortgages. It would be possible for FSLIC to borrow indirectly through a section 406 corporation. Of course as with any borrower at the Fed's discount window, FSLIC would have to provide acceptable collateral Given the state of FSLIC's reserves, it is unclear how much could be raised in this fashion.

Borrowing from the Federal Home Loan Banks

FSLIC has the authority under 12 U.S. 1725(d) and 12 U.S.C. 1431(k) to borrow from the Federal Bome Loan Bank system. The Garn-St Germain Act P.L 97-320) allows FSLIC to borrow from the Federal Home Loan Banks, as long as the rate on the loan is not less than the Banks marginal cost of funds. There are two other limitations on FSLIC borrowings. First, FSLIC must provide sufficient collateral based on terms and conditions set by the Federal Home Loan Bank Board. Second, the Bank system itself has a limit on the amount of funds it can raise through borrowing. The Bank system can in turn obtain funds through the issuance of consolidated obligations. By regulation, it cannot borrow in excess of 12 times the paid-in capital stock and reserves of all the banks. These debt instruments are not obligations of the United States (12 U.S.C. 1435) nor do they carry any governmental guarantees.

FSLIC has exercised this authority twice to arrange pass-through loans, once for \$200 million and the other time for \$700 million. The Office of Management and Budget (OMB), according to Treasury, had a problem with their budgetary treatment of the loans: one was shown as an expenditure which increased the budget deficit and the other was treated as a guarantee. According to CBO, when FSLIC borrows directly from the Pederal Home Loan Banks, this financing mechanism permits FSLIC to increase its authority to obligate funds However, when the disbursement occurs, it would be reflected as an outlay. It would, therefore, lead to an increase in the budget deficit.

Under unusual circumstances, other funds are available from the Treasury. The Secretary of the Treasury is authorized to purchase, at his discretion, up to \$4 billion of FHLBank obligations, if he and the Chairman of the Federal Home Loan Bank Board certify to Congress that alternative means of raising funds cannot be effectively employed and the ability to supply such funds is impaired because of monetary stringency and a high level of interest rates (12 U.S.C. 1431(i)). This borrowing authority is not subject to appropriations, and the Treasury may sell public debt securities to raise necessary funds (12 U.S.C. 1431(i)).

APPENDIX IV

APPENDIX IV

Mandatory deposits equal to 1 percent of total deposit

Section 404(h) of the National Housing Act (12 U.S.C. 1727(i)) enables FSLIC to obtain additional liquidity, if necessary, by calling upon insured institutions to make deposits in the Corporation. This authority allows the Federal Home Loan Bank Board to require each insured institution to deposit up to 1 percent of its withdrawable deposits with the FSLIC.

With the deposit base of the industry reaching \$900 billion, there would be between \$8 billion and \$9 billion to be added to FSLIC's reserves. The Bank Board has said that this money could only be used to add liquidity to the Fund, not for case resolutions. Moreover, the 1 percent levy would also have another effect. Under the conditions described here, it would mean an abrupt decrease in the net worth of all thrifts—weakening solvent institutions and driving insolvent thrifts further into insolvency.

Each of the alternative strategies or sources of income discussed here fails to satisfy at least one of the objectives presented at the beginning of appendix I. Either they provide too little money, they use public money (or in the case of the FDIC merger, commercial banks' money), or they increase the deficit. In most cases multiple objectives are violated. While violation of these objectives does not automatically disqualify a proposal, it certainly raises additional questions.

STATEMENT OF

DAVID N. PETERSON

PRESIDENT OF THE SOCIETY OF REAL ESTATE APPRAISERS BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

March 3, 1987 Washington, DC Thank you Chairman St Germain, Mr. Wylie and Members of the Subcommittee. My name is David Peterson. 1 am a partner in the Real Estate Science Corporation in Phoenix, Arizona where I specialize in appraisals of large commercial and income producing properties. I have been a professional real estate appraiser for 26 years and have earned the Senior Real Estate Analyst designation (SREA) of the Society of Real Estate Appraisers, and the MAI designation of the American Institute of Real Estate Appraisers.

I am the 1987 International President of the Society of Real Estate Appraisers which has over 17,000 members. The Society's headquarters are in Chicago, Illinois and we maintain a Public Affairs Office with Legislative Counsel in Washington, DC.

l am accompanied by Dr. William N. Kinnard, Jr., Professor

Emeritus in Finance and Real Estate at the University of Connecticut.

Dr. Kinnard also holds the SREA and MAI designations, and is an approved instructor for the Society's R41c Seminar.

The Society of Real Estate Appraisers

The Society was founded in 1935 as an independent, voluntary membership organization and continues as such today. During the chaotic period of the depression, the need for uniform standards of appraisal

redures and formalized appraisal training arose when foreclosures were mon and there was little market against which housing prices could be spared. Members of the newly formed Society (then known as the sciety of Residential Appraisers") created the standards of a new session and, indeed, created that needed profession itself.

The purposes of the Society of Real Estate Appraisers are to wate the standards in real estate appraising and analysis, to aid in solution of problems of the profession which are faced in appraising analyzing real estate, and to designate certain members as having aimed demonstrable skills and knowledge. The members are pledged to intain a high level of trust and integrity in their practice. It is responsibility of the members to keep up to date with techniques, and market practices; to know and utilize data sources, and to be true of the environmental influences in which client decisions must be le.

In order to assure the public of the highest standard of praisal service, the Society has instituted intensive training programs offers educational courses in all areas of real estate appraising.

Standards of Practice include the requirements of an appraisal, and specify professional standards by which appraisers must conduct their actice.

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Membership in the Society is open to all persons of good character with a serious interest in appraising, and who desire to undertake a rigorous educational program in order to earn one of the Society's professional designations: SRA, SRPA, or SREA (see Appendix 1).

In order for a member to achieve the SRA designation, he or she must have obtained credit for two appraisal course examinations, acquired a minimum of three years of practical residential experience which is rated by peer member review at local and national levels, earned a college degree or its equivalent, and submitted a residential demonstration appraisal report which must be approved by an experienced appraiser.

In order for a member to achieve the SRPA designation, he or she must have obtained credit for four course examinations, acquired a minimum of three years of practical residential and income producing property experience which is rated by peer member review at local and national levels, earned a college degree or its equivalent and submitted a demonstration appraisal report on income producing property which must be approved by an experienced appraiser.

The member designated as an SREA is qualified by advanced training and experience to extend the analysis of property beyond the appraisal for current market value and to provide a basis for decision making to clients responsible for committing funds or making other decisions.

In order for a member to achieve an SREA designation, he or she must hold the SRA or SRPA designation, obtain examination credit from additional course work and have a minimum of five years experience with at least 20% of the working time spent on appraisal and/or analysis of income properties. In addition, reports containing investment cash flow analysis and marketability analysis must be submitted for review.

Further, the applicant must appear before the Analyst Admissions

Committee for a personal interview which is designed to determine the applicant's level of expertise and understanding. These requirements are in addition to those necessary to obtain the SRA or SRPA designation.

The original Senior Real Estate Analyst Certificate is granted for five years. Application for recertification is required at the end of five years and at the end of each five year period thereafter as a condition of recertification. In addition to completing the 60 hour program, in order to be listed in our published directory as "currently certified", the analyst must earn 10 of the 60 hours by attending the Society's Annual Symposium on analysis.

The Society's Standards specify that the appraiser's compensation must be based on the "responsibility entailed and the work and expense involved". Society members are precluded from accepting compensation for services in the form of a commission, rebate or division of brokerage commissions. Nor can they accept compensation for an appraisal which is contingent upon the appraised value of the property.

Estimates of the number of practicing appraisers in the United States vary between 150,000 and 250,000 individuals. Our best estimate is that only about 60,000 of these practitioners belong to appraisal organizations with similar requirements and standards.

Origins of Appraisal Concerns

Previous Congressional hearings dealing with real estate financing difficulties, problem appraisals, lender and regulatory deficiencies have focused attention upon appraisers and the functions they perform in the mortgage related activities of federal agencies, departments, and federally insured financial institutions.

In the early 1970s, three important real estate marketing and financial developments occurred. Real Estate Investment Trusts (REIT's) were introduced. The condominium form of ownership became more commonplace. And, a surge of lending-investment activity into construction and development projects was begun by financial institutions (especially thrifts).

These were inter-related developments. The record of REIT's illustrates that the people managing the REIT's took few precautions.

Many saw no difference between a real estate transaction and a credit transaction. A major problem was that appraisals were not obtained until after the fact, if at all.

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During this period, large in-house appraisal staffs were maintained within life insurance companies and thrift associations. They were often regarded as training grounds for fee appraisers. A problem for the in-house appraisers with the insurance companies was the focus on analyzing an already determined situation. A market study or feasibility analysis would be provided to the appraiser by someone in the "loan development" or "investment" department. The life insurance companies did not train their appraisers to do market analyses, forecasts and feasibility analyses. The appraisal could be obtained after the loan was closed and the project underway.

Thrift institutions at that time were a different matter.

Traditionally, they had been required to obtain appraisals for single-family residential loan purposes in advance of the closing of the loan. Thrifts were accustomed to having appraisals done in advance.

Thrifts were accustomed to a three or four day turn-around time for an appraisal. With the shift to independent fee appraisers, busy, local appraisal firms in active markets found the turn-around time possible and also profitable. With the new marketing and financial devices, things began to change.

In the environment of REIT's, Condos, and construction lending, time was of the essence. Prompt action was needed, for competitive purposes. The reality was that developers were generally responsible for appraisals. Developers initiated the requests for appraisals and then

"shopped" the loan packages. One of the elements of that loan package typically was an appraisal. Appraisals often were used to justify decisions on projects where the projects were substantially changed subsequent to the appraisal.

Appraisers commonly were presented with "feasibility studies" that were prepared by others. Often, these "feasibility studies" were prepared at the request and on behalf of the developer. Appraisers were asked to utilize the conclusions of the feasibility studies given them without further independent investigation on their own. This was part of the system, it was part of obtaining business.

In the mid-1970s to the early 1980s, rapid turnaround was essential for an appraiser to continue to work for a developer or financial institution. The time factor was one of the reasons that some appraisals were ordered after the fact. Within this marketplace there was pressure on the appraiser to come up with the "right" number. If a loan decision had already been made, the appraiser was expected to justify the conclusions of the underwriter/lender. Many thrift associations transferred their in-house appraisal operations to their service corporations. Some see this as a conflict of interest.

The lender needed certain levels of "value" to justify loan amounts. The amount of "value" had to be equal to the amount of the loan when 100% financing was legalized. Unfortunately, many non-real estate

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elements were incorporated within the loan, and not identified separately for a separate non-real estate loan.

The developers wanted to do deals. They didn't want to be told that a project wasn't worth what they thought it would cost. Pressure was on the appraiser to produce the right number.

During the recession of the mid-1970s and the early 1980s, lenders found that some borrowers were unable to meet their obligations or were simply walking away from projects. The result was that real estate owned (REO) became very important in some areas (especially among savings and loan associations that had been eager for development projects and loans). In this instance, pressure on appraisers to come up with a "value" at least as high as the outstanding amount of the loan was very great indeed.

Developers and lenders tended to "shop" the appraisal assignment. In some market areas appraisers participated in price-cutting in order to keep the business of major developers and large lenders. As a result, appraisers found themselves in a cost squeeze and sometimes cut corners.

The 1980s witnessed increasing attention on appraisers and the appraisal process from lenders, insurors and federal regulators. This attention and scrutiny was a consequence of the volume of defaulted and

foreclosed commercial and income property loans. FSLIC-insured thrift institutions in particular have been hard hit. Institution mergers and failures have become frequent. The stability of the FSLIC insurance fund is in doubt. The commercial banking system has also been exposed to problems stemming from commercial real estate loan defaults, foreclosures and losses.

From its inception during the Depression of the 1930s until the early 1960's, the watchword of the appraisal industry regarding real estate value was caution. The men and women responsible for educating appraisers and building the foundation upon which modern appraisal theory and practice has been built have memories of the real estate and financial institutions debacle of the 1920's and 1930's. With changing social policy favoring home ownership, the mortgage finance market was altered in the 1960s. A period of growth, increasing inflation and rising property values produced optimistic projections concerning future growth patterns.

The deregulation of the financial industry during the past several years has created an atmosphere which has allowed some very aggressive lenders to become involved with creative lending programs. In many instances these creative lending programs have led to substantial overbuilding in some areas of the country.

In the early 1980s, as problems in mortgage financing surfaced, attention began to focus on the Pederal Home Loan Bank Board's appraisal requirements. The Bank Board expected the appraiser to undertake a feasibility analysis. It was expected that the appraisal be delivered prior to the loan decision. Appraisers were supposed to look at the plans and specifications if proposed construction was involved.

Changes in the Bank Board's appraisal requirements came about because the Board believed it needed requirements which would help protect the institutions in changing market environments. As a result, appraisal reports take longer to produce, require more justification and documentation, and since they have to be ordered and dated prior to the date of the loan decision, fast action on the part of lenders is limited. The costs to the lender or client have increased substantially in some markets.

Today's Hearing

The Society of Real Estate Appraisers appreciates this opportunity to testify and provide the Subcommittee with technical assistance on appraisal issues relative to these hearings. The recapitalization of the PSLIC fund is of significant importance to our membership. Many of our members provide appraisal services for PSLIC insured institutions.

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The Society of Real Estate Appraisers acknowledges the need for regulatory agency appraisal guidelines. The Society compliments the Federal Home Loan Bank Board on its efforts to develop and implement requirements to encourage the use of quality appraisers and appraisal reports within the system. The quality of appraisal work throughout the United States has improved because of the diligence of the Board. The Society has attempted to respond to the Board's memoranda concerning appraisal requirements by developing educational courses designed to educate and familiarize our membership with those requirements. It should be noted that the Society and other responsible appraisal organizations have standards of professional practice. These industry standards permit varying levels of documentation to be requested by a client.

In the R41c Memorandum (see Appendix II), the Bank Board made a decision regarding the level of documentation it would consider appropriate to meet its obligation to protect the FSLIC insurance fund. The amount of appraisal documentation which the Board requires is a policy matter. Whether the requirements of R41c are excessive cannot be answered in a vacuum. The Society of Real Estate Appraisers has offered to assist the Bank Board during its deliberations concerning the application of appraisal standards and practice so that policy judgments can be fully thought through before decisions are made. In recent discussions with members of the Board we have been assured that we will be invited to assist the Board in the development of future appraisal regulations.

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In your earlier deliberations on this issue, questions regarding appropriate appraisal guidelines for thrift institutions have been raised. To the extent that I can help the Subcommittee to better understand the role of the appraiser, I am happy to be of service.

FEDERAL HOME LOAN BANK BOARD MEMORANDUM R41c

R4lc is the latest in a series of internal memoranda which have been issued by the Office of Examination and Supervision of the Bank Board. The memorandum sets forth the standards and reporting requirements utilized by the Bank Board in determining compliance with the appraisal requirements of the Board's Insurance Regulations (563.17-1(c)(1)(iii)). R4lc has broad application to federally insured thrift institutions, some federally insured mutual savings banks, their subsidiaries, and others.

The R41 series of memoranda has been in existence since June 1977. In September 1977, R41a was issued, followed by R41a1 in March 1979. R41b was issued in March of 1982. It was not until mid to late 1984, however, that the requirements of R41b began to be strictly enforced in conjunction with the implementation of the Appraised Equity Capital Regulation. This enforcement led to rejection of appraisal reports in the loan files of insured thrift institutions. The solvency of some insured institutions was put in jeopardy. Discussions with the Bank Board resulted in the development of educational seminars by the

Society of Real Estate Appraisers and others. Yet, the enforcement of the appraisal requirements and the enhanced educational efforts by the Society were not sufficient to remedy valuation and underwriting practices quickly enough to stem the tide of defaults, foreclosures and failures. The Bank Board then devised an altered and expanded version of R41b. The result was the issuance of R41c in September 1986.

R41c establishes specifications and requirements for a form appraisal report format, and a narrative report format. It contains a definition of market value and gives requirements for valuation dates and methodology, and appraiser qualifications. R41c is addressed to the PSLIC Examination Staff, the PHLBB Appraisal Staff and to the Insured Thrift Institutions' Management.

R41c has significant impact on real estate loan underwriting because all real estate loans of federally-insured thrift institutions are liable to the terms, conditions and sanctions of the classification of assets rules and regulations.

R41c applies to purchases of loans by Freddie Mac. To be eligible for Freddie Mac purchase, the loan package must contain appraisal reports complying with R41c. R41c requirements therefore may be applicable to appraisals on real estate loans originated by lending institutions or mortgage bankers that are outside the Bank Board-FSL1C systems.

The wide ranging effect of the appraisal guideline has been significant. The impact upon the quality of appraisal reports now found in the FHLB System has been dramatic. Greater knowledge of the Board's requirements and its enforcement efforts have tended to raise the level of appraisal practice despite the criticism received from some quarters.

Attention has focused on the differences between R41b and R41c. We thought that it would be helpful to highlight some of the differences which we preceive.

- The parallel introduction of the Classification of Assets system to the FHLBB examination process, and amendment of the FHLBB Loan Recordkeeping Requirements.
- Explicit requirements that tangible personal property and intangibles be separated out in any project analysis and evaluation.
- Explicit recognition that non-real estate property or project may be funded (and therefore valued) separately by thrift institutions.
- Purther emphasis on responsibility of thrift institution management for compl ance of appraisals used in real estate loan and investment underwriting decisions.
- New emphasis and requirements that multiple value estimates be developed, presented and properly labeled for all proposed construction projects.
- Explicit mention of the possibility of criminal proceedings against appraisers under the terms of Title 18 of the U.S. Code.
- Requirement that PHLBB's definition of Market Value (which is the same as that adopted by PNMA and PHLMC as of July 1, 1986) be used, to the exclusion of all others.

 Sales histories of comparable sales properties are required, with terms of sale and financing for each transaction reported, whenever speculative market conditions are encountered.

Additionally, there are differences in detail, specification and explanation of many individual points between the contents of R4lb and R4lc.

- Market Value is explicitly and unequivocally a Cash Equivalency figure, and must be measured and reported as such.
- All required sales histories of subject properties must cover a period of three (3) years, except for 1-4 family residential properties (which call for one-year sales history).
- R41c applies to all properties, regardless of size or price level, including those for which a standard, official (URAR, FMNA, FHLMC, FHA, VA, FmHA) appraisal report form is both applicable and acceptable.
- 4. Even more emphasis is placed on the conclusions of Highest and Best Use. The proposed use of every property, whether existing or not on the appraisal date, must be tested for economic feasibility.
- One required valuation date in every appraisal of proposed construction is the forecast or estimated date of completion of construction.
- The time to complete proposed construction must be explicitly estimated, and supported with market evidence to the extent possible.
- 7. Market conditions of demand and supply (competition) expected to exist as of the date of completion (valuation date) and the date of forecast stable occupancy (additional valuation date) for proposed construction must be explicitly forecast, and supported from market evidence to the extent possible.

- In sellouts analyses for proposed construction entrepreneurial profits from the marketing and risk-taking functions must be explicit "expense" deductions.
- 9. The expected sellout or lease-up period (absorption period) for all proposed construction projects must be analyzed in terms of market conditions forecast to exist as of the date of completion and expected to extend through the sellout or lease-up period.
- 10. The Cost New (or Cost to Produce) estimate for all proposed construct on must be based on contractors would bid on the project as of the date of the appraisal (the "As Is" date), not what it would cost to complete the project on the "As Is" date. In other words, estimating Cost New based on instantaneous construction is not acceptable.
- All Limiting Conditions and Assumptions contained in the appraisal analysis must be presented in one place in the appraisal report.
- 12. The appraiser's Certification must contain certain specified statements.

Still, much of the content and substance of R41b and its decessors remain. The objective of the valuation must still be Market ue (as defined by PHLBB). Self-contained, stand-alone narrative orts that apply (or attempt to apply) all three recognized approaches value are still required. Most important, the substance of R41c is 11 a set of specifications and requirements for appraisal report mat and contents.

As appraisers have begun implementing the reporting requirements R4lc, some concerns, both substantive and interpretative, have arisen.

- the time and costs required to fulfill all the requirements of R41c;
- the necessity of estimating future value; 2.
- the definition and meaning of "value upon completion" and "value as if at stablized occupancy";
- the issue of discounting;
- R41c applicability to single family dwellings; and 5.
- that appraisers can become enmeshed in aspects of the underwriting process under R41c;

In our opinion the following changes and clarifications would improve the effectiveness of the Board's appraisal requirements:

- 1. Clarify whether lender staff appraisers are allowed to appraise institution's Real Estate Owned (REO).
- 2. Clairfy whether an otherwise complying appraisal may be transferred from one would-be lender to another.
- 3. Clarify whether "Value Upon Completion" and "Value Upon Achievement of Stabilized Occupancy" are: a. "Market Value" Estimates, or b. "Puture Value" Estimates.
- 4. Clarify what "properly protected over the life of the credit arrangement" means.
- 5. Require institutions to help appraisers obtain needed information.
- 6. Omit from R41c coverage:
 - a. All existing 1-4-family residential properties.
 - b.
 - All properties on loans less than \$250,000. All properties on loans less than 2% of net worth in c. range of \$12,500,000 to \$50,000,000.
- 7. Specify that all "Value Upon Completion" and "Value Upon Achievement of Stabilized Occupancy" estimates must employ Discounted Cash Flow Analysis. The same applies to all Market Value estimates for existing rental-income properties.

- Clarify that "Highest and Best Use" means "Economic Feasibility of the Proposed Use" for R41c purposes.
- Clarify "probable success" and "economic feasibility" to refer to proposed use.
- 10. Clarify what "entrepreneurial profit" is.
- 11. Clarify valuation of leased fee and leasehold interests.
- 12. Clarify what a "complete explanation of all comparable data adjustments" means in practice.

The Society of Real Estate Appraisers acknowledges the need for regulatory agency appraisal guidelines. The Society has attempted to respond to the Bank Board's requirements with education courses specifically designed to address those guidelines. We have been unable to achieve all of the goals which need to be met, yet we are still trying. We remain generally supportive of the concepts underlying the R41 series.

Classification of Assets Regulation

The appraisal process and the classification of assets functions are inter-related. The Classification of Assets Regulation, as we understand it, requires additional allocation of net worth to cover anticipated capital loss from loans that show a weakness such as delinquent payments or inadequate coverage of debt service from property income. The system is an integral part of "re-evaluation of real estate assets" by the Bank Board Examination Staff.

In June 1986 the classification of assets system established three classifications of "problem assets" including real estate loans. Classifications are "Substandard", "Doubtful", and "Loss". An appraisal report that does not comply to R41c can render the entire loan package "Substandard".

An asset is "Doubtful" that exhibits discernible loss potential where some loss seems very likely. A seriously deficient or non-conforming appraisal in the asset file could lead to a "Doubtful" classification.

An asset is classified a "Loss" when some or all of it is considered uncollectible. The "Loss" classification initially requires a 100% specific reserve against the book value of the asset. An acceptable reappraisal may allow for a lesser amount of specific loss reserve.

PASB 15

Asset classification has to do with the valuation of the loan, which is the asset of the lender. Appraisers estimate the market value of the collateral for the loan. Once you have the information on the value of the collateral, then giving a value to the loan is a matter of policy and accounting principles. The accounting principles deal with valuing the asset of the lender association.

One way a loan becomes a troubled asset to the lender is insufficient income from the property to cover the debt service.

Restructuring is essentially aimed at reducing the amount of debt service required so that the income from operating the collateral property is sufficient to cover the debt service.

At what point non-performing assets start influencing the perception of the safety of the institution by regulators and examiners are policy questions. In deciding policy, the question arises, "if we had to convert this asset with its underlying collateral into cash, what could we get for it"? A market value estimate, or an appraisal using market value as the objective, would give you a value of the collateral.

The concept of market value seeks to establish "the most probable price in terms of money which a property should bring in an open market under conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus". In dealing with income property where benefits are to be derived from future revenue, there are forecasts of those future amounts. Those forecasted amounts, because they are going to be received in the future, are worth less than if they would be received today. The idea of the time value of money applies. Those future amounts are generally discounted back to the present at a rate of return that the typical purchaser/investor could earn on alternative competitive investment. A holding period discount used by an appraiser to develop market value should be based on a market-derived discount rate.

In the accounting field, the holding costs to an owner are used, and when that owner is a lending institution, the cost of money is their cost of funds rate. The cost of funds rate is a legitimate rate to use insofar as the asset is concerned but not insofar as the collateral is concerned. This is because the only place where the value of that collateral is going to be realized is on the market.

with the Classification of Asset system, if R4lc were rescinded and not replaced with anything else, the S&Ls would remain in a similar position as today. Appraisal reports might not cost quite as much because they wouldn't necessarily be as demanding in reporting detail. However, the Classification of Asset system establishes the necessity to write down a loan. It requires an appraisal, or a re-appraisal of the property as a collateral for the loan in order to establish the loan loss reserve. That appraisal is a market value estimate. If there were no R4lc we would still have to abide by the Uniform Standards of Professional Appraisal Practice put forth by the Society of Real Estate Appraisers and other appraisal organizations.

The Classification of Assets system brings the market value of the collateral determined by an appraisal to bear on the value of the asset. This is the arrangement that brings these two together for regulatory purposes.

- 21 -

H. R. 1063

In your letter of invitation, Mr. Chairman, we have been asked to comment on H. R. 1063. The bill requires, among other things, that procedures of the Bank Board for appraisals be prescribed only by regulation. To the extent that this would require full review and comment of proposed rules which would impact the appraisal process, we would support this concept. We believe that a better understanding of the appraisal requirements of the regulatory agencies would be achieved through review and comment prior to implementation. In addition to better understanding, appraisers and others could participate in the formulation of appraisal requirements and attempt to have them reflect the technical capacity and professional standards of the industry. We would suggest that you guard against disallowing all guidance memoranda. Clarification of regulations through the issuance of memoranda is a legitimate agency function as long as it remains within the scope of the regulation explained. Other aspects of the bill may need revision in order to fully distinguish between appraisal and accounting functions.

The Society in cooperation with the other major appraisal organizations is in the process of adopting Uniform Standards of Professional Appraisal Practice. Legislative proposals affecting appraisals should reference and incorporate these uniform standards.

RECENT ACTION OF THE FEDERAL HOME LOAN BANK BOARD

Based upon the news release of the Bank Board, the Office of Regulatory Policy, Oversight and Supervision (ORPOS) has attempted to clarify portions of R4lc.

The clarification deals with four issues:

- residential issues;
- form reports;
- 3. underwriting responsibilities; and
- 4. present market value issues.

Unfortunately, we have, as yet, been unable to review the actual document. I believe it will be released tomorrow.

A copy of the news report is included in our testimony (see Appendix III).

ACTIVITIES OF THE SOCIETY OF REAL ESTATE APPRAISERS IN RESPONSE TO PROBLEMS CONFRONTING THE APPRAISAL PROPESSION

The Society has joined with eight other North American appraisal organizations to form the Ad Hoc Committee on Uniform Standards of Professional Appraisal Practice. The Ad Hoc Committee first met in Chicago in February 1986, and has continued to meet regularly to formulate and draft the Uniform Standards of Professional Appraisal ...

Practice. This Committee began its work in response to criticism

- 23 -

rding faulty appraisals. As anticipated, the U. S. House Government ations Subcommittee, chaired by Congressman Barnard, recommended that orm standards for the appraisal profession be promulgated. The Ad Committee has proposed adoption by the appraisal organizations of the orm Standards it has drafted. At the February Board of Governors ing just concluded, the Society became the first to adopt, effective 1, 1987, all ten standards as promulgated by the Ad Hoc Committee Appendix IV).

Additionally, in anticipation of the recommendations of the ard Report, the appraisal industry has formed a second committee of esentatives to develop a self-regulatory organization (SRO) for the stry. Through several meetings, that Select Committee has begun ting articles of incorporation and bylaws for an appraisal dation. The SRO will feature a National Standards Board and a ification Board which will ensure enforcement of appraisal standards effective discipline of certified appraisers.

A federal task force is being formed which will consist of esentatives from the various federally insured financial institution lators, federal housing agencies, real estate lenders and insurors, g with appraisers. This task force will focus on the problems facing aisers, lenders and regulators and will make recommendations for tions. The Federal Home Loan Bank Board has begun the organizational ess for this task force.

We expect to participate on this task force and continue to interact directly with the Bank Board, other regulators and agencies. It is our continuing goal to enhance the delivery of professional appraisal services to the public and all users of appraisals.

Mr. Chairman, this concludes my comments and I will be happy to answer any questions you may have.

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Membership Eligibility

An includual who wishes to qualify as a Senior Residential Approber must first join The Society as a Candidate member

*Condidate membership in the Society is open to of personal or post of the Condition who desire to underfole a program of professional including and to acquire the desire for product experience in preparation for a career as a professional real estate approach.

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SRA Professional Designation Program

To obtain the Sentor Residential Approber (SRA) designation, a Candidate member

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Property. This course inhoctuces the student to the hundranding principles of test property opposing and the technical sittle employed in the technical sittle employed in the capabication to residential property. Case studies are utilized intought, out the 55 hours of classroom hand, in the course exemination covers of techne madestits and outside seconds asserting the course.

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Experience Requirements

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Standards of Professional Practice and Conduct

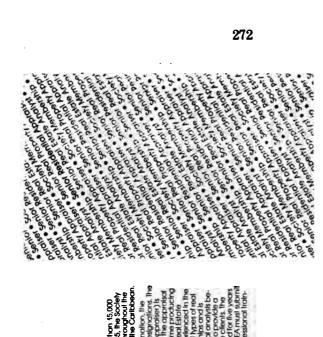
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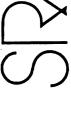
The Society of Real Estate Approximents the largest independent association of professional real estate approximent and analysis

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Membership Eligibility

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SRPA Professional Designation Program

To obtain the Sentor Real Property Appraiser (SRPA) designation, a Canaldate must be a member for one year and:

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*Applied Residential Property volucion.

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Recertification

maintain a personal program of continuing education as a condition of professional membership in the Society. A minimum of 60 classroom hours of continuing education is required every five years to be recentlified. All designated members are urged to

Slandards of Professional Practice and Conduct

The Society has established high Standard of Professional Practice and Conduct to Slandards consist of a Code of Ethics, the which every member must adhere. The Slandards of Professional Procile Slandards of Professional Con.

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In addition to the SRPA designation, the Society owards the SRA (Sentor Residential Approach Approach and the SRAS (Sentor Read Estate Analys) (sesponsions, the SRAs is toneed and expenienced in the approach of residential properties. The SREA is frained and expenienced in the approach of residential properties. The SREA is frained and expenienced in the approach and ordered and of all types of read estatis in rights or and yet. making to clients. The SREA designation is awarded for the years only. To be recertified. appraisal analysis beyond current market ownerships and is qualified to extend the linued professional training and perform an SREA must submit evidence of convalue to provide a basis for decision-



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eal Estate Analyst (SREA) is an /analyst designated by the Society of a Approxisers as a specialist in real state and a specialist in real state interests and ownershos in the interests and ownershos in the with the accepted definitions of live. Through advanced training and et his SREA has demonstrated ability the analysis beyond the approach market value in order to provide the a basis for decision making when gituras or assets to a real estate to dany kind. The SREA provides consultations, teasibility analyses, 1/cosh flow and risk analyses.

ation Prerequisites

PA Designation

epiec as an applicant for Analyst up, an individual must have ly complemed the SRA (Senior Resipraiser) or the SRPA (Senior Real parciser) comissions program conll experience, education, and after report requirements in effect for rive pessignations.

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a years of experience in which no less of working time was spent on the (analysis of income properties is restuding experience in marketability, and investment/cash flow analysis.

nai Training

ir prerequisite, an applicant must ination credit for the Society's 1 "Special Applications of Appraisal OR all three Level 300 Short Courses In Introduction to Cash-flow and Risk "Mortest and Marketability Analysis," itment Feasibility Analysis," three all training offerings develop systobern-solving approaches applical estate appraisal and analysis Drill problems are employed extensiphout the courses.

Professional Contributions

Through such activities as active participation in professional organization work, teaching, developing recognized courses in appraisal/applysis, and writing or research on appraisal/anolysis subjects, an applicant must have a positive record of contribution to the advancement of the profession.

Certification

Certification procedures require inspection of office operations, severe of appraisal/ondivisine ports (which must include investment feasibility, cash flow, and market analysis), an investigation of applicant's competence and integrity, and a personal interview with members of the Analyst Admissions Committee. The process includes contact with other professional analysts and appraisers, clients, afformers, judges, and persons in the applicant's community.

Recertification

A member wishing to renew the SREA designation must apply for recertification every five years ofter becoming designated. Upon application for recertification, an applicant is expected to show evidence of integrity, continued technical training, experience and professional leadership commensurate with current SREA admissions standards. Review of reports and/or a personal interview may be required.

Standards of Professional Practice and Conduct

The Society has established high standards of professional practice and conduct to which every member must adhere. These standards consist of a Code of Ethics, the Standards of Professional Practice and the Standards of Professional Conduct.

Individuals believing they have reason to auestion a member's professional performance may notify the Society. The Society maintains systematic and judicious procedures whereby it protects its members from unjust complaints and administers appropriate discipline to those members who violate the Standards.

The Society of Real Estate Appraisers

The Society of Real Estate Appraisers is the largest independent association of protessional real estate appraisers and analysts in North America with approximately 16,000 members. Established in 1935, the Society currently has chapters throughout the United States, Canada, and the Caribbean.

In addition to the SREA designation, the Society awards two other designations. The SRA (Senior Residential Appraiser) is trained and experienced in the appraisal of residential properties. The SRPA (Senior Real Property Appraiser) is trained and experienced in the appraisal of both residential and income producing property.





For further information on the professional real estate appraiser contact: Society of Real Estate Appraisers® 645 North Michigan Chicago, Illinois 60611 (312) 346-7422

FEDERAL HOME LOAN BANK BOARD OFFICE OF EXAMINATIONS AND SUPERVISION MEMORANDUM R-41c

APPENDIX II

t: Francis M. Passarelli

September 11, 1986

THIS MEMORANDUM REVISES AND REPLACES R-UL. IT DOES NOT REPRESENT ANY SHIFT IN BOARD POLICY BUT IT DOES ENCOMPASS SIGNAFICANTLY GREATER DETAIL, SPECIFICALLY WITH REGARD TO "APPRAISAL MANAGEMENT," ADDING GUIDELINES WHICH ARE APPROPRIATE TO ENSURE ACCEPTABLE APPRAISAL PROCEDURES IN THE CURRENT MARKET. THE GUIDELINES LISTED ARE GOVERALLY IABLE APPRAINAL PROCEDURES IN THE CURRENT MARKET. THE GUIDZENES LISTED ARE GENERALD STANDARDS OF PRACTICE UTILIZED BY THE LEADING NATIONAL PROFESSIONAL APPRAÍSAL ORGANIZATIONS. THE MEMORANDUM ALSO CONTAINS THE NEW DEFINITION OF MARKET VALUE, AS RECENTLY ADOPTED BY BOTH THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC) AND THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNE MAE). R-115 IS HEREY KENDERED

: coundness of an association's or service corporation's mornane and real estate investments depends to a great screen upon sequery of appraisals utilized to support such transactions. This estadam sets forth the standards and reporting requirements d by the Federal Home Loan Bank Board in determining cone with the appraisal requirements of it 7-1(c)(1)(iii).

gament Policies

a and investment policies established by an institution's board actors should reflect both the overall operational policies of the atom as well as the regulatory limitations under which it must at he business. Such policies should be clearly defined and set in a measure that provides effective appreciation of the institutionaments by the directors, deat lean policy should identify the types of credit arrange—the institution offers as well as the procedures to be followed underwriting of each of these arrangements. In scurred credit actions, each policies should definitely address the need to ish the value of collateral offered by borrowers in order to enant the institution is appropriately protected throughout the life credit arrangement. To a great extent, the complexity and ity of the credit arrangements offered by borrowers in order to enant the beard of derectors' and senior officers' responsibility to a that the appraisal services provided, whether by see or statistics, properly reflect the collateral lending posture of the riton, as well as its lending policies, and lending posture of the riton, as well as its lending policies, distributed, Appraisal services utilized by the institution's regulatory issued procedures relative to other investments of station. Appraisal services utilized by the institution's regulatory ison to operate in a safe and sound manner. Fallare to ensure persists services mutch the needs of the institution will be conduct an abdication of this responsibility and is representative of an

ppraisal services match the needs of the institution will be con-d an abdication of this responsibility and is representative of an

e and unsound operating policy.

oranulating its loan and investment policies, the board of direcormulating its loan and investment policies, the board of directional recognise that appropriate appraisal services are most produced by fee or staff appraisers, who are both competent movinelgashle and have properly equipped facilities within to prepare adequate appraisals. Each association or service ration should be able to demonstrate that the appraisers and by the board of directors possess the requisite experience, tion and facilities to perform in an acceptable fashion. praisal skills and technology are not static and attendance at as and participation in the activities of professional appraisal

organizations are factors to be considered by the board of directors in selecting both fee and staff appraisers. Memberships in professional appraisal organizations as well as continuous professional development should be encouraged to ensure that the appraisers whose services are being utilized are actively increasing their knowledge and skills over time. Management should periodically review the performance of all approved appraisers for compliance with the standards and reporting requirements of the Federal Home Loan Bank Board and take whatever steps are necessary to eliminate poor quality or inappropriate work products.

Appraisal Management

Appraisal Management
Appraisals serve as an important basis in the decision process involved in the underwriting of secured credit transactions as well as
investment decisions involving interests in real property. Management must ensure that appraisals utilized in these decisions:

- Are prepared in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board and conform with the institution's written appraisal guidelines. Management should provide appraisars approved by the institution with a copy of both the board's requirements, as promulgated herein, and the institution's written guidelines. Management should also assist appraisers in obtaining the information needed to comply with these requirements. Such information includes leases, pur-chase agreements, profit and loss statements from the security property, etc.
- Are sufficiently current to reduce the lifesilhood of material changes in actual market conditions from those upon which the loan or investment decision were predicated. (Though not esclu-sively definitive, 'sufficiently current' may be deemed to be an raisal made six months prior to the ap-
- 3. Reflect the market value of the rights in realty offered as security or involved with the transaction. All other values or interests appraised must be clearly labeled and segregated, i.e., value of chattels, value of financing terms, business value, furniture, fur-nishings and equipment value, etc.
- Contain sufficient information to assist management and/or the board of directors in establishing the loan amount as well as other significant terms involved in the credit arrangement.
- Support the classification of the asset as a real estate loan or other type of credit arrangement.
- Are prepared by appraisers, independent from the borrower or the seller of the real estate, and approved by the institution's

Memorandum R-41c of the Fo

(From page 3) board of directors. It is suggested the board review the pric work and references of newly engaged appraisers. Final board of directors' approval should be recorded in the board's minutes

- 7. Contain adequate information relative to both current and projected market conditions and their resulting impact upon the estimated value of the property to enable an institution to determine whether its financial position will be properly protected over the life of the credit arrangement or term of investment. The scope of such information will depend upon the property type, the structure of the credit or investment arrangement and the financial realities of the contemplated transaction.
- 8. Are presented in a narrative style format, unless both of the following conditions are met:
 - a. A form report is utilized which is appropriate for the specific appraisal assignment, i.e., the form is designed for both the
 - property type and the interests being appraised.

 b. A form report is utilized, including all attachments, that results in a totally self-contained appraisal, as defined elsewhere in this me
- exerviser in uss memorandum.

 9. Are based upon the following definition of market value:
 The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: conditions whereby:

 - conditions whereby:

 a. buyer and seller are typically motivated;

 b. both parties are well informed or well advised, and each acting
 in what he considers his own best interest;

 c. a reasonable time is allowed for exposure in the open market;

 d. payment is made in terms of cash in U.S. dollars or in terms of
 financial arrangements comparable thereto; and

 e. the price represents the normal consideration for the property
 sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.
- 10. Correctly employ all recognized appraisal methods and techniques that are necessary to produce a credible analysis, opinion, or conclusion. Exclusion or omission of any recognized method for cause must be fully justified.
- for cause must be fully justified.

 1. Consider, analyze and disclose in reasonable detail:

 a. Any current agreement of sale, option, or listing of the property being appraised.

 b. Any prior sales of the property being appraised that occurred within the following time periods:

 (1) one year preceding the date when the appraisal was prepared for one to four family residential property, and
 (2) three years preceding the date when the appraisal was prepared for all other property types.

 c. A sales history of comparables, if the subject property is located in a speculative market, which has experienced dramatic price fluctuations relative to resional norms, covering the fluctuations relative to regional norms, covering the lative time period involving the comparable sales. price fluct
- 12. Contain the following information where an analysis, opinion or ion of a proposed project, improvement or change in use concusion or a propose project, improvement or change in use is involved: (i) plans, specifications, or other documentation in sufficient detail to identify the scope and character of the pro-posed improvements; (ii) evidence indicating the probable time of completion of the proposed improvements; (iii) clear and appropriate evidence supporting development costs, anticipated rent levels or per unit sales levels, occupancy projections, and the anticipated competition at the time of completion; and (w) all value changes projected to occur from the conception of a project to its completion and/or stabilized occupancy should be set

forth in sufficient detail so that the continuum of present value estimates over the life of the credit arrangement or investment can be reconciled with the values reported in the appraisal. Ined as documentation should be an explanation of how dis count and capitalization rates used in generating the present e estimates were deduced.

In addition to the above requirements, whenever value is esti-mated as of completion and/or stabilized occupancy, the appraisal must contain the following information:

a. The date or dates when the value estimate or er

- b. Factual data supporting the reasonableness of all condit ions impacting each value conclusi appraisal. Such information must be presented in sufficient detail and directly linked to current market information so that the appraiser's logic, reasoning, judgment and analysis in-dicate to a third-party reader the reasonableness of the value
- or values reported.

 c. An explanation of the appraisal techniques selected and the data used to arrive at the final value estimate(s).

 d. A fully documented and supported highest and best use analysis and conclusion which coincides with the date(s) of the
- A definitive statement as to whether the value estimate reflects the worth of the property at stabilized occupancy and whether the appraiser considered and included the effect of income and expenses during the projected absorption period in developing a value estimate as of the date of completion.

a value estimate as or the case or competent.

3. Accurately reflect the impact upon value of any changes in plans and specifications from those utilized in an appraiser's analysis of a proposed project, improvement or change in use.

In all instances where an institution utilizes an appraisal based upon preliminary plans and specifications in a loan or investment decision, it shall take appropriate steps, prior to the disbursement of any funds, to ensure the validity of the appraisal, relative to the decision, has not been negated. Further, whenever significant changes in plans and specifications occur after a loan or investment decision has been made, the institution's management shall take ammorates stems, a security in events. after a loan or investment decision has been made, the institu-tion's management shall take appropriate steps to ensure its financial position is appropriately protected. Typically, such steps will involve either having the original appraiser recertly his states will involve either having the original appraiser recertly his value estimate after examining the final plans and specifications for the project or a new appraisal will be obtained based on the final plans and specifications. For the purposes of this paragraph, significant changes in plans and specifications are defined as those which directly affect the value of the property, e.g., changes in the scope, character or timing of the proposed improvements.

- 14. Contain a properly documented and supported estimate of the highest and best use of the property appraised, which is consis-tent with the definition of market value cited in this memoran-dum. Such estimate must consider the effect on use and value of dum. Such estimate must consider the effect on use and value of the following factors: existing land use regulations, resonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the optimal usage of the property. In addition, the appraisal must consider the effect on the property being ap-praised of anticipated improvements as of the appraisal date.
 - In all appraisals, incuding those involving proposed construction, development or changes in use, the appraiser must specifically address and consider in his analysis the anticipated economic feasibility, as well as cite all significant market data utilized in de-veloping his/her conclusions. Such analyses must be presented in sufficient detail to support the appraiser's forecast of the prob-able success and the conclusion of highest and best use of the
 - In all instances where the apprai ketability studies prepared by a third party to support his esti-

al Home Loan Bank Board

- mate of highest and best use, he must:

 a. Actest that such study has been thoroughly examined and that
 he fully concurs with its findings and conclusions, and:
- a. Attest that dearn stuay has been thoroughly examined and in-he fully concurs with its findings and conclusions, and: b. Specifically identify both the study examined as well as ef-forth within the body of the appraisal. a summary of the sig-nificant data, analyses and conclusions presented in the study. Such summary must be presented in sufficient detail, so that further reference to the study is unnecessary by a third-party
- reader of the appraisal, and:

 c. Have available for future examination by users of the appraisal, a complete copy of the feasibility /marketability study prepared by the thard party.
- prepared by the third party of the date of completion for all properties, wherein a pertion of the overall real property rights or physical asset would typically be sold to its ultimate users over some future time period. Valuations involving such properties must fully reflect all appropriate deductions and discounts as well as the anticipased cash flows to be derived from the disposition of the asset over time. Appropriate deductions and discounts are considered to be those which reflect all expenses associated with the disposition of the raily, as of the date of completion, as well as the cost of capital and entrepresentation profit. all experience date of completion trepreneurial profit.
- 16. For properties under construction, conversion or proposed, report the market value of the subject property as of the date of completion, excepting those properties described in paragraph 15 completion, excepting those properties described in paragraph 15 immediately above, where anticipated market conditions indicate stabilized occupancy is not likely as of the date of completed values for all fully reflect the impact upon the "as if completed values" of all pertinent operating expenses as well as the anticipated pestern of income during the absorption period. In addition, the value estimate must reflect the impact of rental and other concessions, including the costs associated with preparing the improvement for occupancy by tenants.
- Contain a summary of actual income and expenses experienced by the subject property where it is an existing income or revenue by one adopted property wrater it is an entiring income or revenue producing property, in addition, all such appraisals must contain a complete reconclisation of all deviations projected by the ap-pealese in his forecast of future financial performance from those historically realized by the property.
- 18. Report the "as is" value of the subject property, as of the date when either the appraisal was prepared or when the property was last impacted. The date of the "as is "value estimate should be sufficiently current to reduce the likelihood of material changes in the actual market conditions from those upon which the loan or investment decision were predicated. In addition to any other value estimates contained in an appraisal, the "as is" value must be reported.
- 19. Consider and report the effect on value, if any, of the terms and conditions of any agreement establishing a fractional interest or estate, where the objective of the report is to estimate the value of such fractional interest or estate. All such appraisals must of such fractional interest or estate. All such appraisals must-charrly demonstrate that the value of any fractional part or estate has been evaluated by an analysis of appropriate market data. Such analyses must recognize that it is generally considered inappropriate to arrive at either the value of the whole or its parts by simply summing the fractional interests or subdividing the value of the whole into proportional parts. All analyses involving fractional interests or estates, where the combined value of all interests or estates is not reported, must definitely establish with market evidence whether the terms and conditions of the arreveneral treating the seates or fractional in-

definitely establish with market evidence wheumer the userus amonditions of the agreement creating the estates or fractional interests reflects market rates and terms.

In addition to the above requirements, all analyses involving fractional interests or estates must disclose whether the final value estimate of such fractional interests or estates included

other non-really contractual arrangements, etc. Jurther, whenever such value estimate includes non-really components, the value estimate includes non-really components, the value estimate includes non-really components, the value assignable to them must be specifically disclosed in the appraisal. All appraisals, where there is a clear indication that the subject

property is encumbered by a lease instrument or legal limitati property is encumbered by a lease instrument or legal limitations upon its operation [e.g., when inspection reveals occupancy of the property by tenants or the property is subject to rent control statutes], must consider and report the impact of the terms of the lease or such legal limitations upon the value of the estate being appra

Appraised Content
Pror to the approval of a loan or investment transaction, each appraisal accepted by an institution must be prepared in writing and contain sufficient information to enable the persons who reserve or rely on the report to understand it property. Appraisals which fail to set forth, in a clear and accurate manner, the analytical process followed by the appraiser, in a fashion that will not be misleading to the peacers who receive or rely on the report, will be considered unacceptable.

The content of each appraisal accepted by an institution shall sllow generally accepted and established appraisal practices, as flicted in the standards of nationally recognized professional ap-raisal organizations and as noted in the body of this memorandum. al organizations and as now... ecifically, each appraisal must:

- Be totally self-contained so that when read by any third party, the appraiser's logic, reasoning, judgment and analysis in arriv-ing at a final conclusion indicate to the reader the reasonableness of the market value reported.
- 2. Identify via a legal description the real estate being appraised.
- 3. Identify the property rights be appraised.
- 4. Describe all salient features of the property being appraised.
- State that the purpose of the appraisal is to estimate market value as defined in this memorandum.
- 6. Set forth the effective date of the value conclusion(s) and the date of the report.
- Set forth all relevant data and the analytical process followed by the appraiser in arriving at the highest and best use conclusion.
- 8. Set forth the appraisal procedures followed, the data considered, Set forth the appraisal procedures rouowed, me cata consistent wand the reasoning that supports the analyses, opinions, and conclusions arrived at by the appraiser. The analytical process followed by the appraiser must be presented so that: (all't includes a complete explanation of all comparable data adjustments, suttined in the analysis together with appropriate market support for each adjustment, and;

 - puscenties utilized in the analysis together win appropriate market support for each adjustment, and; lit contains descriptive information for all comparable data presented with sufficient detail to demonstrate the transac-tions were conducted under the terms and conditions of the definition of value being estimated or have been adjusted to meet such conditions; have a highest and best use equivalent to the best use of the subject property, and; are physically and economically comparable to the subject property.
- SOMEONICALLY COMPARABLE TO THE BUDGET PROPERTY.

 9. Set forth all assumptions and limiting conditions that affect the analyses, optinions, and conclusions in the report; however, such assumptions and limiting conditions must not result in either a non-marker value estimate or one so limited in scope that the final product will not represent a complete appraisal. A summary of all such assumptions and limiting conditions must be presented in one physical location within the appraisal.
- Include a manually signed certification by the appraiser that is similar in content to the following form:
 the statements of fact contained in this report are true and

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- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- and concustoms.

 I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.

 my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the
- use of, this report.

 my analyses, opinions, and conclusions were developed, and this report has been prepared, in accordance with the standards and reporting requirements of the Federal Home Loan Bank Boart.
- Dank pouru.

 I have made a personal inspection of the property that is the subject of this report. If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection
- on any water individuals due not make a personal impection of the appraised property. In on one provided significant professional assistance to the person signing this report. [If there are exceptions, the name of each individual providing significant professional assistance

Related Considerations
Appraisal reports prepared for the purpose of influencing in any way the action of a Federal Home Loan Bank Board, a Federal Home Loan Bank Board, a Federal Savings and Loan Association, any institution the accounts of which are insured by the FSILC, any member of the Federal Home Loan Bank System, or the Federal Savings and Loan Insurance Corporation are subject to the provisions of Title 18, United States Code, It is encumbent upon all appraisars to diligently adhere to generally accepted professional appraisal standards of practice and the provisions and requirements of the Federal Home Loan Bank Board's standards and reporting requirements relating to the preparation of appraisal reports prepared for these entities.

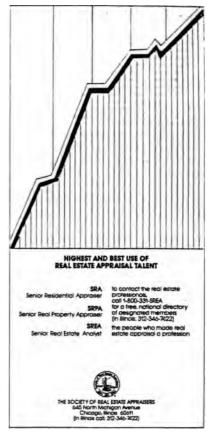
Francis M. Passarelli Director [FHLBB]

Kinnard Writing R-41c Seminar

With the Federal Home Loan Bank Board's release of Memoranwith the Federa Floor Boath south boaths regarded or presented and R-4Ls, the Society is preparing an accompanying seminar. Dr. William N. Kinnard, Jr., SREA, the author of 'R-41b and the Appraiser," will also be the author of the Society's new R-4Ls offering. The seminar should be available for chapter presentation by late

Pilot Presentation of R-41c and the Appraiser, Tucson, Arizona, Arizona Inn, November 7; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Thomas A. Baker, 2500 N. Tucson Blvd., Suite 100, Tucson, AZ 85716; (602) 881-1700; sponsored by Tucson #116;

Pilot Presentation of R-41c and the Appraiser, San Diego, California, Inter-Continental Hotel, November 20; Dr. William N. Kinnard, Jr., SRA, instructor, Contact: Don Knox/Janan Fussell, 4452
Park Blvd., #302. San Diego, CA 92116; (619) 295–1670; sporsoored by San Deigo #33; 7 hours recertification credit.



"Highest and Best Use," one of the four magazine adverti which have been placed throughout the year to promote Society members, will appear during the latter part of 1986 in the following publications: Corporate Real Estate, National Law Journal, Trial,

and Mortgage Benking.

During the last quarter of 1986, those who request copies of the Directory of Designated Members will receive the 1987 issue, which will be mailed in January. For those who need immediate information, copies of local listings from the current directory are available.

ERPT FROM FHLBB NEWS RELEASE DATED February 26, 1987)

APPENDIX III

Appraisal Reforms

Chairman Gray announced an important staff action taken in ponse to concerns that have been raised regarding certain aspects appraisal guidelines contained in R-41c. The Office of Regulatory icy, Oversight and Supervision ("ORPOS") has today issued a rification intended to alleviate those concerns. Today's ORPOS forandum seeks to clarify four important matters:

- Compliance with Freddie Mac and Fannie Mae underwriting appraisal and appraisal reporting guidelines (and standard form reports) is considered sufficient for appraisals on existing one-to-four family dwellings and multi-family properties.
- 2. In order to assist in cost control of appraisal services, the Bank Board encourages the appraisal industry to develop standardized forms that are consistent with uniform appraisal standards, for use wherever possible. Such forms would have to be pre-approved by the Bank Board.
- 3. It'is not intended that the appraiser become enmeshed in aspects of the underwriting process other than those necessary to perform the appraisal.
- 4. An appraiser shall report a present market value for both existing properties and for proposed developments. The appraiser may also report a value as of the conclusion of construction and as of the projected date when stabilized occupancy is achieved.

The Congress has complimented the Bank Board's appraisal anderds. The Bank Board has taken the lead in seeking to develop propriate appraisal standards. A recent House Committee report notluded: "Among all the Federal banking agencies, only the FHLBB a highly developed and comprehensive system regarding appraisal licies, practices and procedures."

Indeed, the House Committee report recommended that all federal nancial institution insurers and regulators should undertake "the velopment and dissemination of appraisal guidelines utilizing the LBB's Hemorandum $\pm R - 41b$, as a model".

Chairman Gray expressed his belief that, as clarified, the ard's appraisal standards are an important safeguard for the fustry. The clarifications to R-41c are designed to reduce costs the industry. The Chairman is hopeful that standardized appraisal rms can be developed promptly that will significantly reduce the sts and delays of obtaining an appraisal.

Chairman Gray also indicated his desire to move even more badly to enhance the Bank Board's appraisal standards. In nouncing that he will ask the Bank Board to propose a rule, whose roose would be to revise, as appropriate, its appraisal standards, a Bank Board Chairman said again he would press for the broadest sible range of public comments on what-appraisal standards should used in the thrift industry.

Uniform Standards of Professional Appraisal Practice

AD HOC COMMITTEE

on

UNIPORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE Chicago, Illinois February 8, 1987

To Our Respective Organizations:

The undersigned constitute the Ad Hoc Committee on Uniform Standards of Professional Appraisal Practice. The attached document is a further step in a continuing response to the concerns of users of appraisal services and the public.

The document contains Standards 1 through 8 of August 24, 1986 and Explanatory Comments developed since that time, along with Standards 9 and 10, Re: Business Appraisals and Explanatory Comments. We recommend immediate adoption by each organization either as re-stated Standards of Professional Practice document or as an adjunct to the existing Standards of Professional Practice document. We stand in concert and are ready to discuss and defend the development of the document with the appropriate committees, boards, and/or councils of our respective organizations.

Harold N. Butler Appraisal Institute of Canada

Joe S. Durant
American Society of
Farm Managers and.
Rural Appraisers

John L. Gadd American Society of Appraisers

William J. Hamilton National Society of Real Estate Appraisers

Denaid E. Elhs International Right of Way Association

Jonn J. Leary American Institute of Real Estate Appraisers

Ritch LeGrand | Society of Real Estate Appraisers

ian W. Mc International Association of Assessing Officers

Keef J. Urfa National Association of Independent Fee Appraisers 1

UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE PREAMBLE

It is essential that a professional appraiser arrive at and communicate his or her analyses, opinions, and advice in a manner that will be meaningful to the client and will not be misleading in the marketplace. These Uniform Standards of Professional Appraisal Practice reflect the current standards of the appraisal profession.

These standards include a Competency Provision which places an immediate responsibility on the appraiser prior to acceptance of an assignment. The standards contain binding requirements, as well as specific guidelines to which a Departure Provision applies under certain conditions. Definitions applicable to these standards are also included.

These standards deal with the procedures to be followed in developing an appraisal, analysis, or opinion and the manner in which an appraisal, analysis, or opinion is communicated. Standards 1 and 2 relate to the development and communication of a real estate appraisal. Standard 3 establishes guidelines for reviewing an appraisal and reporting on that review. Standards 4 and 5 address the development and communication of various real estate analysis functions. Standard 6 sets forth criteria for the development and reporting of mass appraisals for ad valorem tax purposes. Standards 7 and 8 establish guidelines for developing and communicating personal property appraisals. Standards 9 and 10 establish guidelines for developing and communicating business appraisals.

These standards are developed for appraisers and the users of appraisal services. To maintain the highest level of professional practice, appraisers will observe these standards. The users of appraisal services should demand work performed in conformance with these standards.

COMPETENCY PROVISION

Prior to entering into an agreement to perform any assignment, an appraiser must carefully consider the knowledge and experience that will be required to complete the assignment competently and either:

- have the knowledge and experience necessary to complete the assignment competently; or
- with regard to appraisal, review, and analysis as defined herein, immediately disclose the lack of knowledge or experience to the client, and take all steps necessary or appropriate to complete the assignment competently; or
- with regard to mass appraisal as defined herein, immediately take all necessary or appropriate steps to ensure the mass appraisal is developed under the supervision of an appraiser who has the qualifications referred to in Standard 6.

DEPARTURE PROVISION

An appraiser may enter into an agreement to perform an assignment that calls for something less than, or different from, the work that would otherwise be required by the specific guidelines, provided that prior to entering into such agreement:

- the appraiser has determined that the assignment to be performed is not so limited in scope that the resulting appraisal, review, or analysis would tend to mislead or confuse the client, the users of the report, or the public; and
- the appraiser has advised the client that the assignment calls for something less than, or different from, the work required by the specific guidelines, and therefore the report will include a qualification that reflects the limited or differing scope of the appraisal, review, or analysis.

In the context of this departure provision, exceptions to the following binding requirements are not permitted: S.R. 1-1, S.R. 1-5, S.R. 2-1, S.R. 2-3, S.R. 2-5, S.R. 3-3, S.R. 4-1, S.R. 5-1, S.R. 5-3, S.R. 6-1, S.R. 6-5, S.R. 6-6, S.R. 7-1, S.R. 8-1, S.R. 8-3, S.R. 9-1, S.R. 9-3, S.R. 9-5, S.R. 10-1, S.R. 10-3 and S.R. 10-5.

JURISDICTIONAL EXCEPTION

If any part of these standards is contrary to the law or public policy of any jurisdiction, only that part shall be void and of no force or effect in that jurisdiction.

DEFINITIONS

For the purpose of these standards, the following definitions apply:

ANALYSIS: the act or process of providing information, recommendations and/or conclusions on diversified problems in real estate other than estimating value.

APPRAISAL: the act or process of estimating value.

CASH FLOW ANALYSIS: a study of the anticipated movement of cash in or out of real estate.

CLIENT: any party for whom an appraiser performs a service.

FEASIBILITY ANALYSIS: a study of the cost-benefit relationship of an economic endeavor.

INVESTMENT ANALYSIS: a study that reflects the relationship between acquisition price and anticipated future benefits of a real estate investment.

 ${\tt MARKET}$ ANALYSIS: a study of real estate market conditions for a specific type of property.

MASS APPRAISAL: the process of valuing a universe of properties as of a given date utilizing standard methodology, employing common data, and allowing for statistical testing.

MASS APPRAISAL MODEL: a mathematical expression of how supply and demand factors interact in a market.

PERSONAL PROPERTY: identifiable portable and tangible objects which are considered by the general public as being "personal," e.g., furnishings, artwork, antiques, gems and jewelry, collectibles, machinery and equipment.

REAL ESTATE: an identified parcel or tract of land, including improvements, if any.

REAL PROPERTY: the interests, benefits, and rights inherent in the ownership of real estate.

REPORT: any communication, written or oral, of an appraisal, review, or analysis; the document that is transmitted to the client upon completion of an assignment.

 $\ensuremath{\mathsf{REVIEW}}\xspace$ the act or process of critically studying a report prepared by another.

STANDARD 1

In developing a real estate appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

STANDARDS RULES RELATING TO STANDARD 1

S.R. 1-1

In developing a real estate appraisal, an appraiser must:

- (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;
- (b) not commit a substantial error of omission or commission that significantly affects an appraisal;
- (c) not render appraisal services in a careless or negligent manner, such as a series of errors that, considered individually, may not significantly affect the results of an appraisal, but which, when considered in the aggregate, would be misleading.

S.R. 1-2

In developing a real estate appraisal, an appraiser must observe the following specific appraisal guidelines:

- (a) adequately identify the real estate, identify the real property interest under consideration, define the purpose and intended use of the appraisal, consider the scope of the appraisal, describe any special limiting conditions, and identify the effective date of the appraisal;
- (b) define the value being considered;

if the value to be estimated is market value, the appraiser must clearly indicate whether the estimate is the most probable price:

- (i) in terms of cash; or
- (ii) in terms of financial arrangements equivalent to cash; or
- (iii) in such other terms as may be precisely defined;

if an estimate of value is based on submarket financing or financing with unusual conditions or incentives, the terms of such financing must be clearly set forth, their contributions to or negative influence on value must be described and estimated, and the market data supporting the valuation estimate must be described and explained;

- (c) consider easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of a similar nature;
- (d) consider whether an appraised fractional interest, physical segment, or partial holding contributes pro rata to the value of the whole;
- (e) identify and consider any personal property, fixtures or intangible items that are not real property but are included in the appraisal.

S.R. 1-3

In developing a real estate appraisal, an appraiser must observe the following specific appraisal guidelines:

- (a) consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the highest and best use of the property;
- (b) recognize that land is appraised as though vacant and available for development to its highest and best use and that the appraisal of improvements is based on their actual contribution to the site.

S.R. 1-4

In developing a real estate appraisal, an appraiser must observe the following specific appraisal guidelines when applicable:

- (a) value the site by an appropriate appraisal method or technique;
- (b) collect, verify, analyze, and reconcile:
 - such comparable cost data as are available to estimate the cost new of the improvements (if any);
 - (ii) such comparable data as are available to estimate the difference between cost new and the present worth of the improvements (accrued depreciation);
 - (iii) such comparable sales data, adequately identified and described, as are available to indicate a value conclusion;
 - (iv) such comparable rental data as are available to estimate the market rental of the property being appraised;
 - such comparable operating expense data as are available to estimate the operating expenses of the property being appraised;
 - (vi) such comparable data as are available to estimate rates of capitalization and/or rates of discount.

No pertinent information shall be withheld.

- (c) base projections of future rent and expenses on reasonably clear and appropriate evidence;
- (d) when estimating the value of a leased fee estate or a leasehold estate, consider and analyze the effect on value, if any, of the terms and conditions of the lease(s):
- (e) consider and analyze the effect on value, if any, of the assemblage of the various estates or component parts of a property and refrain from estimating the value of the whole solely by adding together the individual values of the various estates or component parts;
- (f) consider and analyze the effect on value, if any, of anticipated public or private improvements, located on or off the site, to the extent that market actions reflect such anticipated improvements as of the effective appraisal date;
- (g) identify and consider the appropriate procedures and market information required to perform the appraisal, including all physical, functional, and external market factors as they may affect the appraisal;
- (h) appraise proposed improvements only after examining and having available for future examination:
 - plans, specifications, or other documentation sufficient to identify the scope and character of the proposed improvements;
 - evidence indicating the probable time of completion of the proposed improvements; and
 - (iii) reasonably clear and appropriate evidence supporting development costs, anticipated earnings, occupancy projections, and the anticipated competition at the time of completion.

i.R. 1-5

n developing a real estate appraisal, an appraiser must:

- (a) consider and analyze any current Agreement of Sale, option, or listing of the property being appraised, if such information is available to the appraiser in the normal course of business;
- (b) consider and analyze any prior sales of the property being appraised that occurred within the following time periods:
 - (i) one year for one-to-four-family residential property; and
 - (ii) three years for all other property types;
- (c) consider and reconcile the quality and quantity of data available and analyzed within the approaches used and the applicability or suitability of the approaches used.

STANDARD 2

In reporting the results of a real estate appraisal, an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

STANDARDS RULES RELATING TO STANDARD 2

S.R. 2-1

Each written or oral real estate appraisal report must:

- (a) clearly and accurately set forth the appraisal in a manner that will not be misleading;
- (b) contain sufficient information to enable the person(s) who receive or rely on the report to understand it properly;
- (c) clearly and accurately disclose any extraordinary assumption or limiting condition that directly affects the appraisal and indicate its impact on value.

S.R. 2-2

Each written real estate appraisal report must comply with the following specific reporting guidelines:

- (a) identify and describe the real estate being appraised;
- (b) identify the real property interest being appraised;
- (c) state the purpose of the appraisal;
- (d) define the value to be estimated;
- (e) set forth the effective date of the appraisal and the date of the report;
- (f) describe the scope of the appraisal;
- (g) set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions;
- (h) set forth the information considered, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions;
- set forth the appraiser's opinion of the highest and best use of the real estate being appraised when such an opinion is necessary and appropriate;

- explain and support the exclusion of any of the usual valuation approaches;
- (k) set forth any additional information that may be appropriate to show compliance with, or clearly identify and explain permitted departures from, the requirements of Standard 1;
- include a signed certification in accordance with Standards Rule 2-3.

S.R. 2-3

Each written real estate appraisal report must contain a certification that is similar in content to the following form:

I certify that, to the best of my knowledge and belief:

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have (or have not) made a personal inspection of the property that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.)
- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

S.R. 2-4

To the extent that it is both possible and appropriate, each oral real estate appraisal report (including expert testimony) must address the substantive matters set forth in Standards Rule 2-2.

S.R. 2-5

An appraiser who signs a real estate appraisal report prepared by another, even under the label of "review appraiser", must accept full responsibility for the contents of the report.

STANDARD 3

9

in reviewing an appraisal and reporting the results of that review, an appraiser must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken.

STANDARDS RULES RELATING TO STANDARD 3

S.R. 3-1

In reviewing an appraisal, an appraiser must observe the following specific guidelines:

- identify the report being reviewed, the real estate and real property interest being appraised, the effective date of the opinion in the report being reviewed, and the date of the review;
- (b) identify the scope of the review process to be conducted:
- (c) form an opinion as to the adequacy and relevance of the data and the propriety of any adjustments to the data;
- (d) form an opinion as to the appropriateness of the appraisal methods and techniques used and develop the reasons for any disagreement;
- (e) form an opinion as to the correctness and appropriateness of the analyses, opinions, and/or conclusions in the report being reviewed and develop the reasons for any disagreement.

S.R. 3-2

In reporting the results of an appraisal review, an appraiser must:

- (a) disclose the nature, extent, and detail of the review process undertaken:
- (b) disclose the information that must be considered in S.R. 3-1(a) and (b);
- (c) set forth the opinions, reasons, and conclusions required in S.R. 3-1 (c), (d) and (e).

No pertinent information shall be withheld.

S.R. 3-3

In reviewing an appraisal and reporting the results of that review, an appraiser must separate the review function from any other functions.

STANDARD 4

In developing a real estate analysis, an analyst must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible analysis.

STANDARDS RULES RELATING TO STANDARD 4

R. 4-1

developing a real estate analysis, an analyst must:

- (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible analysis;
- (b) not commit a substantial error of omission or commission that significantly affects an analysis;
- (c) not render analyst services in a careless or negligent manner, such as a series of errors that, considered individually, may not significantly affect the results of an analysis, but which, when considered in the aggregate, would be misleading.

B. 4-2

developing a real estate analysis, an analyst must observe the following recific analysis guidelines:

- (a) clearly identify the client's objective;
- (b) define the problem to be considered, define the purpose and intended use of the analysis, consider the scope of the assignment, adequately identify the real estate under consideration (if any), describe any special limiting conditions, and identify the effective date of the analysis;
- (c) collect, verify, and reconcile such data as may be required to complete the assignment;
 - (i) if the market value of a specific property is pertinent to the analysis assignment, an appraisal in conformance with Standard 1 should be included in the data collection.

No pertinent information shall be withheld.

- (d) apply the appropriate tools and techniques of analysis to the data collected;
- (e) base all projections on reasonably clear and appropriate evidence.

S.R. 4-3

In developing a real estate analysis, an analyst must observe the following specific analysis guidelines when a conclusion or recommendation is required by the nature of the assignment:

- identify alternative courses of action to achieve the client's objective, and analyze their implications;
- identify both known and anticipated constraints to each alternative and measure their probable impact;
- identify the resources actually or expected to be available to each alternative and measure their probable impact;
- (d) identify the optimum course of action to achieve the client's objective.

S.R. 4-4

In developing a real estate market analysis, an analyst must observe the following specific analysis guidelines when applicable:

- (a) define and delineate the market area:
- identify and analyze the current supply and demand conditions that make up the specific real estate market;
- identify, measure, and forecast the effect of anticipated development or other changes and future supply;
- (d) identify, measure, and forecast the effect of anticipated economic or other changes and future demand.

S.R. 4-5

In developing a real estate cash flow and/or investment analysis, an analyst must observe the following specific analysis guidelines when applicable:

- consider and analyze the quantity and quality of the income stream;
- (b) consider and analyze the history of expenses and reserves:
- (c) consider and analyze financing availability and terms;
- (d) select and support the appropriate method of processing the income stream;
- (e) consider and analyze the cash flow return(s) and reversion(s) to the specified investment position over a projected time period(s).

S.R. 4-6

In developing a real estate feasibility analysis, an analyst must observe the following specific analysis guidelines when applicable:

- (a) prepare a complete market analysis;
- apply the results of the market analysis to alternative courses of action to achieve the client's objective;
 - (i) consider and analyze the probable costs of each alternative:
 - consider and analyze the probability of altering any constraints to each alternative;
 - (iii) consider and analyze the probable outcome of each alternative.

STANDARD 5

In reporting the results of a real estate analysis, an analyst must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

STANDARDS RULES RELATING TO STANDARD 5

S.R. 5-1

Each written or oral analysis report must:

- clearly and accurately set forth the analysis in a manner that will not be misleading;
- (b) contain sufficient information to enable the person(s) who receive or rely on the report to understand it properly;



(c) clearly and accurately disclose any extraordinary assumption or limiting condition that directly affects the analysis and indicate its impact on the final conclusion or recommendation (if any).

S.R. 5-2

Each written analysis report must comply with the following specific reporting guidelines:

- (a) define the problem to be considered;
- (b) state the purpose of the analysis;
- (c) identify and describe the real estate under consideration (if any);
- (d) set forth the effective date of the analysis and the date of the report;
- (e) describe the scope of the assignment;
- (f) set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions;
- (g) set forth the information considered, the analysis procedures followed, and the reasoning that supports the analyses, opinions, and conclusions:
- (h) set forth the analyst's final conclusions or recommendations (if any);
- set forth any additional information that may be appropriate to show compliance with, or clearly identify and explain permitted departures from, the requirements to Standard 4;
- (j) include a signed certification in accordance with Standards Rule 5-3.

S.R. 5-3

Each written analysis report must contain a certification that is similar in content to the following form:

I certify that, to the best of my knowledge and belief:

 the statements of fact contained in this report are true and correct.

- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property (if any) that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.
- my compensation is not (or is) contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report. (If the compensation is contingent, the basis of such contingency must be explained.)
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have (or have not) made a personal inspection of the property (if any) that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the property.)
- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

.R. 5-4

o the extent that it is both possible and appropriate, each oral analysis eport (including expert testimony) must address the substantive matters at forth in Standards Rule 5-2.

STANDARD 6

In developing and reporting a mass appraisal for ad valorem tax purposes, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques, that are necessary to produce and communicate credible appraisals within the context of the property tax laws.

STANDARDS RULES RELATING TO STANDARD 6

. 6-1

developing a mass appraisal for ad valorem tax purposes, an appraise π :

- (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;
- not commit a substantial error of omission or commission that significantly affects an appraisal;
- (c) not render an appraisal in a careless or negligent manner;
- (d) employ those recognized mass appraisal procedures and techniques that are necessary to minimize errors in the data and analyses;
- (e) employ those recognized techniques for formulating and calibrating mass appraisal models; and
- (f) employ those recognized mass appraisal testing procedures and techniques that are necessary to ensure that standards of accuracy are maintained.

S.R. 6-2

In developing a mass appraisal for ad valorem tax purposes, an appraiser must:

- (a) adequately identify the real estate, identify the real property interest under consideration, define the purpose and intended use of the appraisal, consider the scope of the appraisal, describe any special limiting conditions, and identify the effective date of the appraisal;
- (b) define the value being considered;
 - if the value to be estimated is market value, the appraiser must clearly indicate whether the estimate is the most probable price:
 - (i) in terms of cash; or
 - (ii) in terms of financial arrangements equivalent to cash; or
 - (iii) in such other terms as may be precisely defined;
- (c) when applicable and when the information is available to the appraiser in the normal course of business, consider easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of a similar nature:
- (d) consider whether an appraised fractional interest, physical segment, or partial holding contributes pro rata to the value of the whole, if applicable;
- (e) identify and consider any personal property, fixtures or intangible items that are not real property but are included in the appraisal.

5.R. 6-3

in developing a mass appraisal for ad valorem tax purposes, an appraiser must:

- (a) consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the highest and best use of the property;
- (b) recognize that land is appraised as though vacant and available for development to its highest and best use and that the appraisal of improvements is based on their actual contribution to the site.

S.R. 6-4

In developing a mass appraisal for ad valorem tax purposes, an appraiser must:

- (a) value the site by an appropriate method or technique;
 - (b) collect, verify, analyze, and reconcile:
 - such comparable cost data as are available to estimate the cost new of the improvement (if any);
 - such comparable data as are available to estimate the difference between cost new and the present worth of the improvements (accrued depreciation);
 - (iii) such comparable sales data, adequately identified and described, as are available to indicate a value conclusion:
 - (iv) such comparable rental data as are available to estimate the market rental of the property being appraised;
 - such comparable operating expense data as are available to estimate the operating expenses of the property being appraised;
 - (vi) such comparable data as are available to estimate rates of capitalization and/or rates of discount.

No pertinent information shall be withheld.

- base projections of future rent and expenses on reasonably clear and appropriate evidence;
- (d) when estimating the value of a leased fee estate or a leasehold estate, consider and analyze the effect on value, if any, of the terms and conditions of the lease;

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- (e) consider and analyze the effect on value, if any, of the assemblage of the various estates or component parts of a property and refrain from estimating the value of the whole solely by adding together the individual values of the various estates or component parts;
- (f) consider and analyze the effect on value, if any, of anticipated public or private improvements, located on or off the site, to the extent that market actions reflect such anticipated improvements as of the effective appraisal date;
- identify and consider the appropriate procedures and market information to perform the appraisal, including all physical, functional, and external market factors as they may affect the appraisal;
- (h) appraise proposed improvements only after examining and having available for future examination:
 - plans, specifications, or other documentation sufficient to identify the scope and character of the proposed improvements;
 - (ii) evidence indicating the probable time of completion of the proposed improvements; and
 - (iii) reasonably clear and appropriate evidence supporting development costs, anticipated earnings, occupancy projections, and the anticipated competition at the time of completion.

S.R. 6-5

In developing a mass appraisal for ad valorem tax purposes, an appraiser must:

- (a) consider and analyze any current agreement of sale, option, or listing of the property being appraised, if such information is available to the appraiser in the normal course of business;
- (b) consider and analyze any prior sales of the property being appraised;
- (c) consider and reconcile the quality and quantity of data available and analyzed within the approaches used, and the adaptability or suitability of the approaches used.

S.R. 6-6

Mass appraisals for ad valorem tax purposes must be supported by documentation that is reasonably accessible to the public and communicated in ways that are not misleading. Documentation may be in the form of (1) records and files in electromagnetic, micrographic, paper, or other storage media, (2) reports, (3) manuals, (4) regulations, (5) statutes, or other acceptable forms. The documentation should substantially conform to the factual requirements of Standards Rule 2-2. Appraisals for ad valorem tax purposes should be certified in a manner consistent with law and with generally

STANDARD 7

In developing a personal property appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

STANDARDS RULES RELATING TO STANDARD 7

7-1

eveloping a personal property appraisal, an appraiser must:

- (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;
- (b) not commit a substantial error of omission or commission that significantly affects an appraisal;
- (c) not render appraisal services in a careless or negligent manner, such as a series of errors that, considered individually, may not significantly affect the results of an appraisal, but which, when considered in the aggregate, would be misleading.

7-2

eveloping a personal property appraisal, an appraiser must observe the wing specific appraisal guidelines:

- (a) adequately identify the object(s) to be valued, including the method of identification:
- define the purpose and intended use of the appraisal, including any special limiting conditions;
- identify the effective date of the appraisal, clearly distinguishing the appraisal date from the report date when appropriate;
- (d) define the value to be considered consistent with the purpose of the appraisal;
- (e) value the object(s) by an appropriate appraisal method or technique;

 collect, verify, analyze and reconcile such data as are available, adequately identified and described, to indicate a value conclusion;

No pertinent information shall be withheld.

S.R. 7-3

In developing an appraisal of certain types of fine art, when applicable, consider and analyze the effect on value of:

- (a) any relevant damage or imperfections;
- (b) the importance of the object(s) as compared to other items of the same type and classification, or as relating to an artist's total work, or as enhancing other parts of a specific collection;
- (c) any historical factors (provenance) which would affect value;
- (d) the market acceptability of the style and scale of the object(s);
- (e) the utility, if any, in today's society as it relates to the originally intended use of the object(s);
- (f) any prior sales of the object(s) being appraised.

STANDARD 8

In reporting the results of a personal property appraisal, an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

STANDARDS RULES RELATING TO STANDARD 8

S.R. 8-1

Each written or oral personal property appraisal report must:

- (a) clearly and accurately set forth the appraisal in a manner that will not be misleading;
- (b) contain sufficient information to enable the person(s) who receive or rely on the report to understand it properly;
- (c) clearly and accurately disclose any extraordinary assumption or limiting condition that directly affects the appraisal and indicate its impact on value.

S.R. 8-2

Each written personal property appraisal report must comply with the following specific reporting guidelines:

- (a) identify and describe the personal property being appraised;
- (b) state the purpose and scope of the appraisal;
- (c) define the value to be estimated;
- (d) set forth the effective date of the appraisal and the date of the report;
- (e) set forth all assumptions and limiting conditions that affect the analyses, opinions, conclusions and valuations;
- (f) where appropriate, set forth the information considered, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, conclusions and valuations;
- (g) when analysis of comparable sales is one of the methods used in the appraisal of personal property for sale purposes, carefully document the sales and analysis;
- (h) set forth any additional information that may be appropriate to show compliance with, or clearly identify and explain permitted departures from, the requirements of Standard 7;
- include a signed certification in accordance with Standards Rule 8-3.

S.R. 8-3

Each written personal property appraisal report must contain a certification that is similar in content to the following form:

I certify that, to the best of my knowledge and belief:

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.



- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have (or have not) made a personal inspection of the personal property that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.)
- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

S.R. 8-4

To the extent that it is both possible and appropriate, each oral personal property appraisal report (including expert testimony) must address the substantive matters set forth in Standards Rule 8-2.

ADDITIONAL DEFINITIONS APPLICABLE TO STANDARDS 9 & 10

BUSINESS ASSETS: Tangible and intangible resources other than personal property and real estate that are employed by a business enterprise in its operations.

BUSINESS ENTERPRISE: A commercial, industrial or service organization pursuing an economic activity.

BUSINESS EQUITY: The interests, benefits, and rights inherent in the ownership of a business enterprise or a part thereof.

STANDARD 9

In developing a business appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

STANDARDS RULES RELATING TO STANDARD 9

S.R. 9-1

In developing a business appraisal, an appraiser must:

- (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;
- (b) not commit a substantial error of omission or commission that significantly affects an appraisal;
- (c) not render appraisal services in a careless or negligent manner, such as a series of errors that, considered individually, may not significantly affect the results of an appraisal, but which, when considered in the aggregate, would be misleading.

S.R. 9-2

In developing a business appraisal, an appraiser must observe the following specific appraisal guidelines:

- (a) adequately identify the business enterprise, assets, or equity under consideration, define the purpose and the intended use of the appraisal, consider the scope of the appraisal, describe any special limiting conditions, and identify the effective date of the appraisal;
- (b) define the value being considered.
 - (i) if the appraisal concerns a business enterprise or equity interests, consider any buy-sell agreements, investment letter stock restrictions, restrictive corporate charter or partnership agreement clauses, and any similar features or factors that may have an influence on value.
 - (ii) if the appraisal concerns assets, the appraiser must consider whether the assets are:
 - (1) appraised independently; or
 - (2) appraised as parts of a going concern.
 - (iii) if the appraisal concerns equity interests in a business enterprise, consider whether the interests are appraised on a majority or minority basis.

S.R. 9-3

In developing a business appraisal relating to a majority interest in a business enterprise, an appraiser must investigate the possibility that the business enterprise may have a higher value in liquidation than for continued operation as a going concern. If liquidation is the indicated basis of valuation, any real estate or personal property to be liquidated must be valued under the appropriate standard.

S.R. 9-4

In developing a business appraisal, an appraiser must observe the following specific appraisal guidelines when applicable:

- (a) value the business enterprise, assets or equity by an appropriate method or technique.
- (b) collect and analyze relevant data regarding:
 - (i) the nature and history of the business;
 - financial and economic conditions affecting the business enterprise, its industry, and the general economy;
 - (iii) past results, current operations, and future prospects of the business enterprise;
 - (iv) past sales of capital stock or partnership interests in the business enterprise being appraised;
 - (v) sales of similar businesses or capital stock of publicly held similar businesses;
 - (vi) prices, terms, and conditions affecting past sales of similar business assets;
 - (vii) physical condition, remaining life expectancy, and functional and economic utility or obsolescence.

No pertinent information shall be withheld.

S.R. 9-5

In developing a business appraisal, an appraiser must:

- (a) select one or more approaches that apply to the specific appraisal assignments
- (b) consider and reconcile the quality and quantity of data available for analysis within the approaches that are applicable.

STANDARD 10

In reporting the results of a business appraisal, an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

STANDARDS RULES RELATING TO STANDARD 10

S.R. 10-1

Each written or oral business appraisal report must:

 (a) clearly and accurately set forth the appraisal in a manner that will not be misleading.

- (b) contain sufficient information to enable the person(s) who receive or rely on the report to understand it properly.
- (c) clearly and accurately disclose any extraordinary assumption or limiting condition that directly affects the appraisal and indicate its impact on value.

S.R. 10-2

Each written business appraisal report must comply with the following specific reporting guidelines:

- (a) identify and describe the business enterprise, assets or equity being appraised.
- (b) state the purpose of the appraisal.
- (c) define the value to be estimated.
- (d) set forth the effective date of the appraisal and the date of the report.
- (e) describe the scope of the appraisal.
- (f) set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions.
- (g) set forth the information considered, the appraisal procedures followed, and the reasoning that supports the analyses, opinions and conclusions.
- (h) set forth any additional information that may be appropriate to show compliance with, or clearly identify and explain permitted departures from, the requirements of Standard 9.
- (i) include a certification in accordance with S.R. 10-3.
- include a letter of transmittal signed by the person assuming technical responsibility for the appraisal.

S.R. 10-3

Each written business appraisal report must contain a certification that is similar in content to the following:

I certify that, to the best of my knowledge and belief:

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions; and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.



- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

S.R. 10-4

To the extent that it is both possible and appropriate, each oral business appraisal report (including expert testimony) must address the substantive matters set forth in S.R. 10-2.

S.R. 10-5

An appraiser who signs a business appraisal report prepared by another, even under the label "review appraiser", must accept full responsibility for the contents of this report.



EXPLANATORY COMMENTS RELATING TO THE HINTPORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE

PREFACE

To provide additional information concerning the background, interpretation, or application of a Standards Rule, these Explanatory Comments Relating to the Uniform Standards of Professional Appraisal Practice are adopted.

Explanatory Comments have been developed for Standards Rules for which additional explanation and interpretation might prove to be helpful. There are no Explanatory Comments for Standards Rules that are axiomatic or have not yet required further explanation; however, additional Explanatory Comments will be developed and others supplemented or revised as the need arises.

COMPETENCY PROVISION

Comment on Competency Provision

Since the background and experience of appraisers varies widely and a lack of knowledge or experience can lead to inaccurate or inappropriate appraisals, the competency provision requires an appraiser to have both the knowledge and the experience required to perform a specific appraisal service competently. If an appraiser is offered the opportunity to perform an appraisal service but lacks the necessary knowledge or experience to complete it competently, the appraiser must disclose his or her lack of knowledge or experience to the client prior to accepting the assignment and then take the necessary or appropriate steps to complete the appraisal service competently. This may be accomplished in various ways including, but not limited to, personal study by the appraiser; association with an appraiser reasonably believed to have the necessary knowledge or experience; or retention of others who possess the required knowledge or experience. If, in the course of performing an appraisal service, an appraiser discovers that he or she lacks the required knowledge or experience, the appraiser must immediately take all appropriate steps to remedy the deficiency.

The concept of competency also extends to appraisers who are requested or required to travel to geographic areas wherein they have no recent appraisal experience. An appraiser preparing an appraisal in an unfamiliar location must spend sufficient time to understand the nuances of the local market and the supply and demand factors relating to the specific property type and the location involved. Such understanding will not be imparted

solely from a consideration of hard data such as demographics, costs, sales and rentals. The necessary understanding of local market conditions provides the bridge between a sale and a comparable sale or a rental and a comparable rental. If an appraiser is not in a position to spend the necessary amount of time in a market area to obtain this understanding, affiliation with a qualified local appraiser may be the appropriate response to ensure the development of a competent appraisal.

DEPARTURE PROVISION

Comment on Departure Provision

Before making a decision to enter into an agreement for appraisal services calling for a departure from a specific appraisal guideline, an appraiser must use extreme care to determine whether the scope of the appraisal service to be performed is so limited that the resulting analysis, opinion, or conclusion would tend to mislead or confuse the client, the users of the report, or the public. For the purpose of this provision, users of the report might include parties such as lenders, employees of government agencies, limited partners of a client, and a client's attorney and accountant. In this context the purpose of the appraisal and the anticipated or possible use of the report are critical.

If an appraiser enters into an agreement to perform an appraisal service that calls for something less than, or different from, the work that would otherwise be required by the specific appraisal guidelines, S.R. 2-2(k), 5-2(i), 8-2(h), and 10-2(h) require that this fact be clearly and accurately set forth in the report.

An appraiser must use extreme care in determining whether to enter into an agreement calling for a report that is something less than, or different from the complete report that would otherwise be required by the specific reporting guidelines. If the limited scope of the report would tend to mislead or confuse the client, the users of the report, or the public, the appraiser must not enter into such agreement.

The requirements of the departure provision may be satisfied by the technique of incorporating by reference. For example, if an appraiser's complete file was introduced into evidence at a public hearing or public trial and the appraiser subsequently prepared a one-page report that (1) identified the property, (2) stated the value, and (3) stated that the value conclusion could not be properly understood without reference to his or her complete file and directed the reader to the complete file, the requirements of the departure provision would be satisfied if the appraiser's complete file contained, in coherent form, all the data and statements that are required by the Uniform Standards of Professional Appraisal Practice. Another example would be an updated report that expressly incorporated by reference all the background data, market conditions,

assumptions, and limiting conditions that were contained in the original report prepared for the same client.

DEFINITIONS

Comment on Definitions

In the Definitions adopted for the Uniform Standards of Professional Appraisal Practice, three terms are used to encompass the work performed by appraisers in the marketplace: analysis, appraisal, and review. These terms are intentionally generic. These standards are intended to apply to all appraisal practice, and the use of other nomenclature by an appraiser (e.g. counseling, evaluation, study, submission, valuation) does not exempt an appraiser from adherence to these standards.

STANDARD 1

In developing a real estate appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

General Comment

Standard 1 is directed toward the substantive aspects of developing a competent appraisal. The requirements set forth in S.R. 1-1, the appraisal guidelines set forth in S.R. 1-2, 1-3, 1-4, and the requirements set forth in S.R. 1-5 generally mirror the appraisal process in the order of topics addressed and can be used by appraisers and the users of appraisal services as a convenient checklist.

EXPLANATORY COMMENTS RELATING TO STANDARD 1

Comment S.R. 1-1(a)

This rule recognizes that the principle of change continues to affect the manner in which appraisers perform appraisal services. Changes and developments in the real estate field have a substantial impact on the appraisal profession. Important changes in the cost and manner of constructing and marketing commercial, industrial, and residential real estate and changes in the legal framework in which real property rights and interests are created, conveyed, and mortgaged have resulted in corresponding changes in appraisal theory and practice. Social change has also had an effect on appraisal theory and practice. To keep abreast of these changes and developments, the real estate appraisal profession is constantly reviewing and revising appraisal methods and techniques

and devising new methods and techniques to meet new circumstances. For this reason it is not sufficient for appraisers to simply maintain the skills and the knowledge they possess when they become appraisers. Each appraiser must continuously improve his or her skills to remain proficient in the real estate appraisal profession.

Comment S.R. 1-1(b)

In performing appraisal services an appraiser must be certain that the gathering of factual information is conducted in a manner that is sufficiently diligent to ensure that the data that would have a material or significant effect on the resulting analyses, opinions, or conclusions are considered. Further, an appraiser must use sufficient care in analyzing such data to avoid errors that would significantly affect his or her analyses, opinions, and conclusions.

Comment S.R. 1-1(c)

Perfection is impossible to attain and competence does not require perfection. However, an appraiser must not render appraisal services in a careless or negligent manner. This rule requires an appraiser to use due diligence and due care, and the fact that the carelessness or negligence of an appraiser has not caused an error that significantly affects his or her analyses, opinions, or conclusions and thereby seriously harms a client or a third party does not excuse such carelessness or negligence.

Comment S.R. 1-2(b)

For certain types of appraisal assignments in which a legal definition of market value has been established and takes precedence, the Jurisdictional Exception may apply to this guideline.

Comment S.R. 1-2(d)

This guideline does not require an appraiser to value the whole when the subject of the appraisal is a fractional interest, a physical segment, or a partial holding. However, if the value of the whole is not considered in the analysis, the appraisal must clearly reflect that the value of the property being appraised cannot be used to estimate the value of the whole by mathematical extension.

Comment S.R. 1-3(a)

This guideline sets forth a list of factors that affect use and value. In considering neighborhood trends, an appraiser must avoid stereotyped or biased assumptions relating to race, age, color, religion, gender, or national origin or an assumption that racial, ethnic, or religious homogeneity is necessary to maximize value in a neighborhood. Further, an appraiser must avoid making an assumption or unsupported premise about neighborhood decline, effective age, and remaining life. In considering highest and best use, an appraiser should develop the concept to the extent that is required for a proper solution of the appraisal problem being considered.

Comment S.R. 1-3(b)

This guideline may be modified to reflect the fact that, in various legal and practical situations, a site may have a contributory value that differs from the value as if vacant.

Comment S.R. 1-4(c)

This guideline requires an appraiser, in developing income and expense statements and cash flow projections, to weigh historical information and trends, current market factors affecting such trends, and anticipated events such as competition from developments under construction.

Comment S.R. 1-4(e)

Although the value of the whole may be equal to the sum of the separate estates or parts, it also may be greater than or less than the sum of such estates or parts. Therefore, the value of the whole must be tested by reference to appropriate market data and supported by an appropriate analysis of such data.

A similar procedure must be followed when the value of the whole has been established and the appraiser seeks to estimate the value of a part. The value of any such part must be tested by reference to appropriate market data and supported by an appropriate analysis of such data.

Comment S.R. 1-4(f)

In concemnation valuation assignments in certain jurisdictions, the Jurisdictional Exception may apply to this guideline.

Comment S.R. 1-4(h)

The evidence required to be examined and maintained under this guideline may include such items as contractor's estimates relating to cost and the time required to complete construction, market, and feasibility studies, operating cost data, and the history of recently completed similar developments.

STANDARD 2

In reporting the results of a real estate appraisal an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

General Comment

Standard 2 governs the form and content of the report that communicates the results of an appraisal to a client and third parties.

EXPLANATORY COMMENTS RELATING TO STANDARD 2

Comment S.R. 2-1(a)

Since most reports are used and relied upon by third parties, communications considered adequate by the appraiser's client may not be sufficient. An appraiser must take extreme care to make certain that his or her reports will not be misleading in the marketplace or to the public.

Comment S.R. 2-1(b)

A failure to observe this rule could cause a client or other users of the report to make a serious error even though each analysis, opinion, and conclusion in the report is clearly and accurately stated. To avoid this problem and the dangers it presents to clients and other users of reports, S.R. 2-1(b) requires an appraiser to include in each report sufficient information to enable the reader to understand it properly. All reports, both written and oral, must clearly and accurately present the analyses, opinions, and conclusions of the appraiser in sufficient depth and detail to address adequately the significance of the specific appraisal problem.

Comment S.R. 2-1(c)

Examples of extraordinary assumptions or conditions might include items such as the execution of a pending lease agreement, atypical financing, or completion of onsite or offsite improvements. In a written report the disclosure would be required in conjunction with statements of each analysis, opinion, or conclusion that is affected.

Comment S.R. 2-2(a) and S.R. 2-2(b)

These two guidelines are essential elements in any report. Identifying the real estate can be accomplished by any combination of a legal description, address, map reference, copy of a survey or map, property sketch and/or photographs. A property sketch and photographs also provide some description of the real estate in addition to written comments about the physical attributes of the real estate. Identifying the real property rights being appraised requires a direct statement substantiated as needed by copies or summaries of documents setting forth any encumbrances.

Comment S.R. 2-2(c), S.R. 2-2(d) and S.R. 2-2(e)
These three guidelines require clear disclosure to the reader of a report the "why, what and when" surrounding the appraisal. The purpose of the appraisal is used generically to include both the task involved and rationale for the appraisal. Defining the value to be estimated requires both an appropriately referenced definition and any comments needed to clearly indicate to the reader how the definition is being applied [cf. S.R. 1-2(b)]. The effective date of the appraisal establishes the context for the value estimate, while the date of the report indicates whether the perspective of the appraiser on the market conditions as of the effective date of the appraisal was prospective, current, or retrospective. Reiteration of the date of the report and the effective date of the appraisal at various stages of the report in tandem is important for the clear understanding of the reader whenever the date of the report precedes the effective date of the appraisal.

Comment S.R. 2-2(f)

This guideline requires that a written report that sets forth the results of an appraisal contain a clear and accurate description of the scope of the appraisal. This guideline is designed to protect third parties whose reliance on an appraisal report may be affected by this information.

The term "scope of the appraisal" means the extent of the process of collecting, confirming and reporting data. The Standards clearly impose a responsibility on the appraiser to determine the extent of the work and of the report in relation to the significance of the appraisal problem. Describing the "scope of the appraisal" is the way in which the appraiser signifies acceptance of this responsibility.

Comment S.R. 2-2(g)

It is suggested that assumptions and limiting conditions be grouped together in an identified section of the report.

Comment S.R. 2-2(h)
This guideline requires the appraiser to summarize the data considered and the procedures that were followed. Each item must be addressed in the depth and detail required by its significance to the appraisal. The appraiser must be certain that sufficient information is provided so that the client, the users of the report, and the public will understand it and will not be misled or confused. The substantive content of the report, not its size, determines its compliance with this specific reporting guideline.

Comment S.R. 2-2(i)

This guideline requires that a written report contain a statement of the appraiser's opinion as to the highest and best use of the real estate being appraised, unless an opinion as to highest and best use is irrelevant or unnecessary. If an opinion as to highest and best use is required, the reasoning in support of the opinion must also be included.

Comment S.R. 2-2(k)

This guideline requires that a written appraisal report or other written communication concerning the results of an appraisal contain sufficient information to indicate that the appraiser complied with the requirements of Standard 1, including the requirements governing any permitted departures from the appraisal guidelines. The amount of detail required will vary with the significance of the information to the appraisal. Information considered and analyzed in compliance with S.R. 1-5 is significant information that deserves comment in any report.

Comment S.R. 2-4

In addition to complying with the requirements of S.R. 2-1, an appraiser making an oral report must use his or her best efforts to address each of the substantive matters in S.R. 2-2.

Testimony of an appraiser concerning his or her analyses, opinions, and conclusions is an oral report in which the appraiser must comply with the requirements of this Standards Rule.

Comment S.R. 2-5

This guideline is directed to the employer or supervisor reviewing and signing the appraisal of an employee or subcontractor. The employer or supervisor is as responsible as the individual preparing the appraisal for the content and conclusions of the appraisal and the report. Using a conditional label next to the signature of the employer or supervisor does not exempt that individual from adherence to these standards.

STANDARD 3

In reviewing an appraisal and reporting the results of that review, an appraiser must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken.

EXPLANATORY COMMENT RELATING TO STANDARD 3

General Comment

The function of reviewing an appraisal requires the preparation of a separate report or a file memorandum setting forth the results of the review process. These appraisers are normally checking for a level of completeness and consistency in the report and cannot be expected to have first-hand knowledge of the subject property and other data in the report. This is a distinctly different function from that addressed in S.R. 2-5. To avoid confusion in the marketplace between these two functions, appraisers reviewing appraisal reports should not sign the report being reviewed.

Appraisers who engage in the function of reviewing an appraisal report must take appropriate steps to indicate to third parties the precise extent of the review process. A separate report or letter is one method. Another appropriate method is a form or check-list prepared and signed by the appraiser conducting the review and attached to the report being reviewed. It is also possible that a stamped impression on the appraisal report signed by the reviewing appraiser may be an appropriate method for separating the review function from the actual signing of the report. To be effective, however, the rubber stamp must briefly indicate the extent of the review process and refer to a file memorandum that clearly outlines the review process conducted.

STANDARD 4

In developing a real estate analysis, an analyst must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible analysis.

General Comment

Standard 4 is directed toward the same substantive aspects of professional practice set forth in Standard 1, but addresses the performance of analysis services. Analysis is a broad term that is applied to studies of real estate other than estimating value. Land utilization studies; highest and best use analyses; marketability, feasibility, or investment studies; and other research-related studies are examples of analysis assignments. An analyst must have the ability to develop an analysis/research program that is responsive to the client's objective; to perform primary research; to gather and present secondary and tertiary data; and to prepare a documented written report.

Standard 4 addresses the concept of identifying the client's objective. A clear distinction must be made between performing an impartial analysis that responds to the client's stated objective and performing an analysis that is intended to facilitate the achievement of the client's objective. Both are legitimate business activities within the realm of professional appraisal practice.

An analyst retained to act as a disinterested third party in rendering an unbiased analysis cannot be compensated in a manner that is contingent on the results of the analysis. However, an analyst may be retained to perform legitimate business activities (e.g. brokerage, mortgage banking, tax counseling, zoning advice) for a fee that is contingent on the results achieved, but only when a clear disclosure of the role being performed by the analyst is made.

In accepting an analysis assignment, an analyst must carefully consider and determine whether the service to be performed is, or would be perceived by third parties or the public to be, a service that carries with it an implied impartiality on the part of the analyst. If so, such an assignment can only be accepted for a fee that is not contingent on the results of the analysis.

EXPLANATORY COMMENTS RELATING TO STANDARD 4

Comment S.R. 4-1

S.R. 4-1 is identical in scope and purpose to S.R. 1-1.

Comment S.R. 4-2

An analysis must begin with a clear identification of the client's objective, which may not be explicit in the client's statement of the assignment. The analyst should precisely define the nature of the problem the client faces and the purpose of the analysis. If the analysis involves a specific property or properties, the analyst should obtain a legal description, street address or other means of specifically and adequately locating the property or properties being analyzed.

The analyst should consider the scope of work to be employed for solving the problem, the methodologies to be used, and the specific research data directly relevant to the assignment. If the market value of a specific property is pertinent to the analysis assignment, an appraisal should also be performed in accordance with Standard 1.

Comment S.R. 4-3

After proper consideration of all alternative courses of action, the analyst should identify the optimum course of action in terms of the client's objective and forecast the likelihood it can be achieved. All conclusions must be logically related to the resources available and the constraints that may limit any of the alternatives.

Comment S.R. 4-4

The analyst snould carefully define and delineate the pertinent market area for the analysis. Supportive reasoning for the selection of the boundaries must be stated. The analyst should identify the specific class(es) of property under consideration and analyze the forces that are likely to affect supply/demand relationships.

The analyst is expected to provide a comprehensive physical and economic description of the existing supply of space for the specific use within the defined market area, an explanation of the competitive position of the subject, and a forecast of how anticipated changes in future supply (additions to or deletions from the inventory) may affect the subject property.

The analyst is expected to project the quantity and price or rent level of space that will be demanded within the particular sub-market. The capture or penetration rates of competitive projects should be examined in sufficient detail to lead to a reasoned conclusion as to the forecasted price or rent levels at which the market is likely to accept the subject space and the estimated absorption or rent-up time period.

The analysis of economic changes in the market in which the property is located may include the following determinants of demand: population, employment, and income characteristics; interest rates; zoning and other regulations; rents and/or sales; new construction planned or underway; vacant sites as potential competition to the subject; transportation; taxes; and the cost and adequacy of sewer, water, power, and other utilities. Forecasting techniques should be relevant, reasonable, practical, and supportable. Regardless of the forecasting models employed, the analyst is expected to provide a clear and concise explanation and description of the models and methodologies.

Comment S.R. 4-5

Since real estate investment decisions are predicated on financial implications, the analysis should define the client's investment criteria, consider major variables in the real estate and financial markets, and forecast the anticipated results. Definitions of the financial indices used

(such as internal rate of return) and explanations of the financial analysis techniques employed should be included.

Comment S.R. 4-6

The first step in feasibility analysis is to complete a market analysis.

The analyst should compare the following criteria from the client's project to the results of the market analysis: the project budget (all construction costs, fees, carrying costs, and ongoing property operating expenses); the time sequence of activities (planning, construction and marketing); the type and cost of financing obtainable; and cash flow forecasts over the development and/or holding period; and yield expectations. The analyst should have enough data to estimate whether the project will develop according to the expectations of the client and is economically feasible in accordance with the client's explicitly defined financial objectives.

STANDARD 5

in reporting the results of a real estate analysis, an analyst must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

General Comment

Standard 5 is identical in purpose to the appraisal reporting requirements in Standard 2. An analyst must explain logically and convincingly the reasoning that leads to his or her conclusions. The flow of information should be orderly and progressive, leading from the broadest to the most specific level of analysis possible. Those topics most critical to the analysis conclusions should receive the most detailed emphasis.

In many business situations involving analysis services, the role of the analyst carries with it an implied impartiality. For this reason, an analyst must exercise extreme caution in undertaking assignments that involve the achievement of the specific goals of a client. A clear and obvious disclosure of the role being performed by the analyst should appear in any written report that results from the acceptance of such an assignment and should at least appear in any letter of transmittal, limiting conditions, and form of summary. In this connection, the appropriate use of the Certification in S.R. 5-3 is required, but not sufficient in and of iteself. Similar disclosure is required in any oral report.

EXPLANATORY COMMENTS RELATING TO STANDARD 5

Comment S.R. 5-1

An analysis report must be sufficiently comprehensive so the client can visualize the analysis problem-and follow the reasoning through each step



of the analytical process. It is essential that throughout the report the data, analyses, assumptions and conclusions be logical and adequately supported. Basic analytical and statistical principles, logical reasoning, and sound professional judgment are essential ingredients of the report.

Comment S.R. 5-2

The analyst should set forth all of the assumptions and limiting conditions under which the analysis is made, and support their validity. Specific assumptions or conditions imposed by the client must be clearly set forth as part of the identification of the objective of the analysis. The analyst must investigate the validity of such assumptions or conditions and give reasons for finding them realistic.

It is improper to omit any of the requirements from an analysis report transmitted to the client without good cause. Any departure from normal procedures and the effect of any unusual factors or conditions in connection with the problem must be explained.

STANDARD 6

In developing and reporting a mass appraisal for ad valorem tax purposes, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques, that are necessary to produce and communicate credible appraisals within the context of the property tax laws.

General Comment

Standard 6 is directed toward the substantive aspects of developing and communicating competent analyses, opinions, and conclusions for ad valorem tax purposes. Two types of appraisals are made for ad valorem tax purposes: individual property appraisals and mass appraisals. Individual property appraisals usually are made when a mass appraisal is being contested. Generally, individual property appraisals should conform to Standard 1 and/or 7. Mass appraisals, which often are developed by teams of people, some of whom may not be appraisers, are the subject of this Standard.

Although appraisal is an important aspect of ad valorem tax administration, other important aspects, including locating and describing property, identifying ownership, determining taxability, making assessments, maintaining cadastral record systems, and satisfying a variety of information needs, result in appraiser-client relationships that are distinctly different from the usual relationships between appraisers and clients.

S.R. 6-1 requires appraisers to keep abreast of changes and developments in individual property and mass appraisal methods and techniques and also requires diligence in the performance of appraisal programs. S.R. 6-2, 6-3, 6-4, and 6-5 address the general procedures to be followed in developing proper analyses, opinions, and conclusions, including specific

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requirements pertaining to defining the value being considered. S.R. 6-6 addresses general requirements for documenting and communicating analyses, opinions, and conclusions and for certifying conclusions.

EXPLANATORY COMMENTS RELATING TO STANDARD 6

Comment S.R. 6-1(a)

S.R. 6-1(a) is identical in scope and purpose to S.R. 1-1(a). Changes in regional economies, development patterns, and property tax legislation have a substantial impact on property assessment.

Comment S.R. 6-1(b)

S.R. 6-1(b) is identical in scope and purpose to S.R. 1-1(b) when making an individual property appraisal. S.R. 6-1(d) applies in mass appraisal.

Comment S.R. 6-1(c)
S.R. 6-1(c) is identical in scope and purpose to S.R. 1-1(c)

Comment S.R. 6-1(d)
This rule requires appraisers for ad valorem tax purposes engaged in mass appraisal to take reasonable steps to ensure that the quantity and quality of the factual data that are collected are sufficient to produce credible appraisals. The requirements for real and personal property differ.

For real property, systems for routinely collecting and maintaining ownership, geographic, sales, income and expense, cost, and property characteristics data should be established. Geographic data should be contained in a complete set of cadastral maps compiled according to current standards of detail and accuracy. Sales data should be collected, confirmed, screened, adjusted, and filed according to current standards of practice. The sales file should be separate from the property record file and should contain, for each sale, property characteristics data that are contemporaneous with the date of sale. Property characteristics data should be appropriate to the mass appraisal models being used, the requirements of classification and property tax policy, the requirements of other government and private users, and the marginal benefits and costs of collecting and maintaining each particular property characteristic. The property characteristics data file should contain data contemporaneous with the date of appraisal as well as current data. It may contain historical data on sales. The property characteristics data collection system should provide for periodic reinspection of all properties and special inspections of properties for which building permits have been issued. Data collectors should be trained, and they should use data collection manuals. The data collection program should incorporate checks and audits to ensure that data are recorded correctly and consistently.

For personal property, systems for routinely collecting and maintaining situs and ownership data, market data (e.g., cost, price, sales and income and expense), and property characteristics data should be established. Personal property data collection systems usually rely heavily on reports of taxable property holdings filed by owners and agents, but appraisers should have systems for verifying and auditing those reports and for discovering unreported taxable property.

Comment S.R. 6-1(e)

Appraisers for ad valorem tax purposes engaged in mass appraisal must develop mass appraisal models that with reasonable accuracy represent the mathematical relationship between property value and supply and demand factors, as represented by quantitative and qualitative property characteristics. Models should be calibrated using generally recognized mass appraisal techniques, including multiple regression analysis and the adaptive estimation procedure, for applying the sales comparison, income, and cost approaches to value. Whenever feasible or appropriate, more than one method should be used in appraising a group of properties.

Since personal property items generally are more homogeneous than real property parcels, personal property valuation models generally are simpler than real property valuation models.

Comment S.R. 6-1(f)

It is implicit in mass appraisal that, even when well-formulated and well-calibrated mass appraisal models are used, some individual value estimates will not meet standards of reasonableness, consistency, and accuracy. However, appraisers for ad valorem tax purposes engaged in mass appraisal have a professional responsibility to ensure that, on an overall basis, models produce value estimates that meet attainable standards of accuracy. This responsibility requires appraisers to evaluate the performance of models, using, as appropriate, goodness of fit statistics, hold-out samples, analysis of residuals, and assessment-ratio data. They also should review individual value estimates before the decision to use those estimates as the basis for assessment is made.

Comment S.R. 6-2

Analagous considerations to those set forth in S.R. 6-2(a) apply to personal property. S.R. 6-3 and S.R. 6-4(a), 6-4(f), and 6-4(h) do not apply to personal property.

Comment S.R. 6-2(a)

In mass appraisal, fee simple interests in property are assumed and appraisers need only identify the real property interest under consideration explicitly when that assumption is not met.

Similarly, the purpose, intended use, and scope of appraisals are assumed to be for ad valorem taxation, which facts do not need to be explicitly defined unless there is an intent to use an appraisal for ad valorem tax purposes for another function.

With respect to special limiting conditions, appraisers for ad valorem tax purposes generally operate under pronounced cost constraints.

Politically acceptable expenditure levels for assessment administration are a function of a number of factors, including the value of the property being taxed and the relative reliance of the client governmental bodies On the property tax. As a result, expenditure levels may be considerably lower than the suggested levels in many areas. Sacrifices in data completeness and accuracy, valuation methods, and valuation accuracy are an inevitable consequence of such fiscal constraints. Appraisers should not be held accountable for constraints that are beyond their control.

Comment S.R. 6-2(b)

The definition of value for ad valorem tax purposes usually is stated in legislation, regulations, or court decisions and may vary with property use. Appraisers for ad valorem tax purposes must determine whether a stated legal definition differs materially from the general requirements of this rule and govern themselves accordingly. However, in mass appraisal it is not necessary for appraisers to define the value being considered explicitly in writing.

Comment S.R. 6-3(a)

S.R. 6-3(a) is identical in scope and purpose to S.R. 1-3(a).

Comment S.R. 6-4(e)
This rule should not be construed to invalidate properly formulated mass appraisal models calibrated by use of the cost approach.

Comment S.R. 6-4(h)

Ordinarily proposed improvements are not formally appraised for ad valorem tax purposes. Appraisers, however, are sometimes asked to provide informal estimates of assessed values of proposed improvements so that developers can estimate future property tax burdens. Sometimes condominiums and units in planned unit developments are sold with an interest in unbuilt community property, the pro rata value of which, if any, should be considered in the analysis of sales data.

Comment S.R. 6-6

For reasons of efficiency, the documentation supporting mass appraisals for ad valorem tax purposes virtually never would be found in a single report. Such matters as the purpose of an appraisal, the date of appraisal, the definition of value, the treatment of divided interests, and the like generally are matters of law and are found in constitutions, statutes, ordinances, regulations, or opinions. The rationale for choosing a particular valuation model and calibration method rarely would be stated in writing, except when specified in regulations or contested in court. The mathematical form of the model should, however, be accessible to qualified interested parties. Property owners and their agents should have access to the property characteristics data on their properties upon request. Value conclusions on all properties should be made accessible to all interested parties.

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STANDARD 7

In developing a personal property appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

General Comment

Standard 7 is directed toward the same substantive aspects set forth in Standard 1, but addresses personal property appraisal.

EXPLANATORY COMMENTS RELATING TO STANDARD 7

Comment S.R. 7-1

S.R. 7-1 is identical in scope and purpose to S.R. 1-1.

Comment S.R. 7-2

These guidelines apply the concepts outlined in S.R. 2-2 to personal property appraisal practice.

Comment S.R. 7-3

This guideline sets forth recognized appraisal methods and techniques for certain types of fine art that are consistent with U.S. Internal Revenue Service requirements.

STANDARD 8

In reporting the results of a personal property appraisal, an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

General Comment

Standard 8 is identical in scope and purpose to the appraisal reporting requirements in Standard 2.

ADDITIONAL DEFINITIONS APPLICABLE TO STANDARDS 9 & 10

Comment on Additional Definitions

To the extent that several of the definitions cited on Page 3 of these Standards apply to business appraisal and include a direct reference to real estate, they are modified for the purpose of Standards 9 & 10.

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STANDARD 9

In developing a business appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.

General Comment:

Standard 9 is directed toward the same substantive aspects set forth in Standard 1, but addresses business appraisal.

EXPLANATORY COMMENTS RELATING TO STANDARD 9

Comment S.R. 9-1(a) S.R. 9-1(a) is identical in scope and purpose to S.R. 1-1(a). Changes and developments in the economy and in investment theory have a substantial impact on the business appraisal profession. Important changes in the financial arena, securities regulation, tax law and major new court decisions may result in corresponding changes in business appraisal theory and practice.

Comment S.R. 9-1(b)

S.R. 9-1(b) is identical in scope and purpose to S.R. 1-1(b).

Comment S.R. 9-1(c)

S.R. 9-1(c) is identical in scope and purpose to S.R. 1-1(c).

Comment S.R. 9-2(b)

S.R. 9-2(b) is identical in scope and purpose to S.R. 1-2(b).

Comment S.R. 9-2(b)(ii)

The value of assets held by a business enterprise may change significantly depending on whether the basis of valuation is acquisition or replacement, continued use in place, or liquidation.

Comment S.R. 9-2(b) (iii)

S.R. 9-2(b)(iii) is identical in scope and purpose to S.R. 1-2(d).

Comment S.R. 9-3

This rule requires the appraiser to recognize that continued operation of a marginally profitable business is not always the best approach as liquidation may result in a higher value. It should be noted, however, that this should be considered only when the business equity being appraised is in a position to cause liquidation. If liquidation is the appropriate basis of value, then assets such as real estate and personal property must be appraised under Standard 1 and Standard 7, respectively.

Comment S.R. 9-4(b)

This guideline directs the appraiser to study the prospective and retrospective aspects of the business enterprise and to study it in terms of the economic and industrial environment within which it operates. Further, sales of securities of the business itself or similar businesses for which sufficient information is available should also be considered.

This guideline also requires the appraiser to investigate and take into account not only that loss of value that results from deterioration due to age but also loss of value due to functional and economic obsolescence. Economic obsolescence is a major consideration when assets are considered as parts of a going concern. It is also the criterion in deciding that liquidation is the appropriate basis for valuation.

Comment S.R. 9-5

This rule requires the appraiser to use all approaches for which sufficient reliable data are available. However, it does not mean that the appraiser must use all approaches in order to comply with the rule if certain approaches are not applicable.

STANDARD 10

In reporting the results of a business appraisal an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

General Comment

Standard 10 is identical in scope and purpose to the appraisal reporting requirements in Standard 2.

EXPLANATORY COMMENTS RELATING TO STANDARD 10

Comment S.R. 10-1(a)

S.R. 10-1(a) is identical in scope and purpose to S.R. 2-1(a).

Comment S.R. 10-1(b)

S.R. 10-1(b) is identical in scope and purpose to S.R. 2-1(b).

Comment S.R. 10-1(c)
This rule requires a clear and accurate disclosure of any extraordinary assumptions or conditions that directly affect an analysis, opinion, or conclusion. Examples of such extraordinary assumptions or conditions might include items such as the execution of a pending lease agreement, atypical financing, infusion of additional working capital or making other capital additions, or compliance with regulatory authority rules.

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Comments S.R. 10-2(a), (b), (c) and (d)

Every business appraisal report must include information sufficient to identify what is being appraised, for what purpose, what type of value is being sought and the date as of which that value applies. If the appraisal concerns equity, it is not enough to identify the entity in which the equity is being appraised but also the nature of the equity, for example: how many shares of common or preferred stock. The purpose may be to express an opinion of value but the indended use of the appraisal must also be stated.

Not only the type of value being sought—fair market value, value in use, etc.—must be stated but it must also be defined clearly. The report date is when the report is submitted; the appraisal date or date of value is the effective date of the value conclusion. This date cannot be later than the report date.

Comment S.R. 10-2(e), (f), (g) and (h)

S.R. 10-2(e), (f), (g), and (h) are identical in scope and purpose to S.R. 2-2(f), (g), (h), and (i).

Comment S.R. 10-2(j)

An appraisal report cannot be anonymous. The appraiser or the person assuming technical responsibility for the appraisal must sign the report. The person assuming technical responsibility for the appraisal must be the person under whose direct supervision the appraisal investigation was conducted and who had final responsibility for the conclusions and opinions of value in the appraisal report. Reports issued by a firm may be signed by the person authorized to sign on behalf of the firm, only if the person assuming technical responsibility for the appraisal also signs.

Comment S.R. 10-4

S.R. 10-4 is identical in scope and purpose to S.R. 2-4.

Comment S.R. 10-5

S.R. 10-5 is identical in scope and purpose to S.R. 2-5.

STATEMENT ON THE FSLIC RECAPITALIZATION PROGRAM

BY

JON S. CORZINE, PARTNER,

GOLDMAN, SACHS & CO.

BEFORE THE

COMMITTEE ON BANKING, FINANCE & URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.

MARCH 3, 1987

March 3, 1987

Mr. Chairman, Members of the Committee. I appreciate nur invitation to appear here before you to testify on some? the considerations which might affect the sale and rketing of the securities of a proposed FSLIC Financing reporation. As you are aware, funding as executed through is corporation would be the centerpiece of the intended capitalization of the Federal Savings & Loan Insurance reporation.

By way of background, my name is Jon S. Corzine. I am a irtner of Goldman, Sachs & Co., where I am the senior :ader in the Fixed Income Securities Division and a member ! the Firm's Management Committee. I have held my current sition with Goldman for two years, before which time I was esponsible for the management of our primary dealership. : I am sure you understand, the primary dealership is isponsible for the underwriting, distribution and secondary for most U. S. Government and Agency irket making scurities, including those of the Federal Home Loan Bank. Goldman is to assess the risk/reward role at plationships which relate to our fixed income underwriting nd trading positions. That responsibility requires that I isess the investment characteristics of many different debt truments in light of how investors will perceive those in characteristics. It is from this expertise and respective that I offer my comments on the potential tractiveness of the proposed financing corporation's acurities to the marketplace.

Some basic points first, which may appear elementary, but I believe very much bear repeating. Under paragraph (3) of subsection (b) of new section 21 of its enacting legislation, the Financing Corporation would bear exclusive financial responsibility for the securities being created. Neither the Federal Home Loan Bank, nor the Federal Savings & Loan Insurance Corporation, nor, most importantly, the guarantee of the full faith and credit of the United States would be available to redeem these obligations, should the Financing Corporation be unable to do so.

The prospective investor will, therefore, scrutinize these securities with a view to assessing the likelihood of timely principal and interest payments. The greater the risk the investor feels that he will not be repaid some or all of the principal and interest owing, the higher the rate of interest he is going to demand in compensation. And the higher the rate of interest the Financing Corporation is obliged to pay, the more it will cost to fulfill its basic

This scrutiny will be especially exacting in the case of e new Financing Corporation because the investor will be infronting both the instruments and the corporation that be issuing them for the first time. The less certain investor is that the structure put in place is jectively secure, the more difficult the sale will be. us, the underwriters will need to work harder at educating e investor and selling the investment. By investor, I am ferring to the large institutions, such as pension funds, surance companies and trust departments of banks with phisticated analysts and researchers. Each of these vestors will have to justify under the applicable federal, ate, or fiduciary standards, why he bought these new struments in the quantity he did and included them in his rtfolio.

This is particularly important given the fact that in cent years, the investment community has become creasingly uneasy over the credit standing of the curities afforded agency status. Reflecting this changing vestor perception, the spreads demanded by investors for ency securities over Treasuries have been volatile among a various Agencies and over various maturity ranges. It also true that absolute spreads have tended to widen. See Exhibit \$1). In general, these changing relative reads can be shown to coincide with those times of idertainty associated with (a) the ecomonic viability of

the Agency in question and (b) the political commitment of the existing Congressional and the Executive Branch to that particular Agency. Both of these factors will be closely studied by the marketplace when it establishes the initial spreads of the proposed funding corporation.

Looking first at the economics of the proposal, I believe that the recapitalization proposal put forward by the Treasury and the Federal Home Loan Bank does have intuitive merit, in view of the presumed scope of the problem that has been indentified. The sources of funding are straightforward — i.e. thrift industry assessments, Federal Home Loan Bank contributions, and capital market resources. Additionally, the program appears expandable if the scope of the FSLIC problem turns out to be larger than anticipated. We still would hope that the bad news is on the table as investors become reluctant participants when faced with anticipated surprises which will in turn be reflected in spreads.

Moreover, the Financing Corporation will be structured appropriately for the broadest possible investor base, with Agency Status for tax treatment, collateral eligibility, and SEC exemption. The time horizon of its charter deals with the long-term nature of the problem and solution, i.e. 40 years. The collateralization of principal payments is feasible and should merit investor acceptance. The availability of the FSLIC assessment adds an important

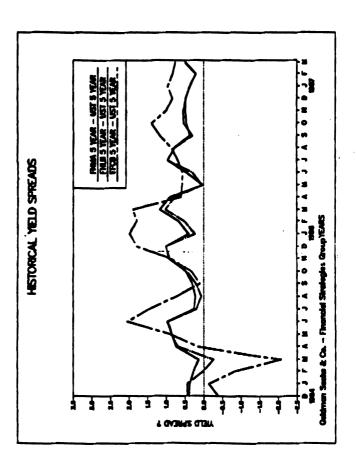
ishion against the uncertainties of unexpected negative ish flows so that the market can look to this feature for iterest payment credibility over time. Finally, the irrest payment times has a ready appetite for reditworthy debt issues in the anticipated maturity range? 15 to 30 years. In short, the program looks marketable the economic side.

On the second set of issues -- relating to political mmitment -- the legislation must be seen as long-term and Any suggestion that Congress will have to wisit this program in the near future, (i.e. 3 to 5 years) · either because the legislation terminates of its own cord after a few years or because the legislation fails in me way to firmly and decisively solve the problems it ldresses -- will have an immediate effect on the investor's Illingness to buy the instruments at an appropriate iterest rate. A sunset provision or the prospect of irther superseding federal legislation would raise the jective possibility that there will be an interruption in or, in a worst case, a default on) the repayment of Moreover, it would raise a incipal and interest. abjective fear that the proposed corporation did not enjoy ne unqualified support of both the Executive and agislative branches. The more the investor perceives this plitical support and a certian structure to reflect that

support, the more likely he is to accept an interest rate closer to that on a Treasury security.

While I have offered the view that the Treasury/Federal Home Loan Bank program could work in the form proposed, I do believe there is merit in other formulations. There certainly is marketplace demand for very substantial amounts of zero coupon bonds. The issues for an alternative proposal would appear to be whether the size of the program would be sufficient to solve the problem and whether the costs of funding repayment of principal would be too burdensome in the long run.

Mr. Chairman, that concludes my prepared testimony. I appreciate this opportunity to present the above views and would be more than happy to answer the questions that you or any member of your committee might have.



STATEMENT

OF

ROSLYN B. PAYNE, PRESIDENT AND CEO
OF THE

FEDERAL ASSET DISPOSITION ASSOCIATION
BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

March 3, 1987

Chairman and Members of the Subcommittee, I welcome the ortunity to appear before you today to provide you with ormation concerning the operations and activities of the eral Asset Disposition Association (FADA) This statement resses four key topics: (1) a current overview of FADA rations and activities, (2) FADA s 1987 outlook, (3) ervations and lessons learned from troubled assets, and (4) effects of H.R. 27 a bill to recapitalize the Federal ings and Loan Insurance Corporation (FSLIC), on FADA.

CURRENT OVERVIEW OF FADA OPERATIONS AND ACTIVITIES

Introduction and Chronology

The Federal Home Loan Bank Board (FHLBB) chartered the Federal Asset Disposition Association on November 5, 1985 to manage, workout, and sell troubled assets for the FSLIC The FADA was organized under Section 406 of the National Housing Act of 1934 as a wholly owned subsidiary of the FSLIC. The charter is for 10 years or until 1995.

On January 31, 1986, the FADA filed with the FHLBB its "Proposed Strategy and Operations," constituting its business plan. The 1986 business plan provides the FADA's mission statement, purpose, and operational strategy. I was selected by the FADA Board of Directors as President and Chief Executive Officer effective February 1, 1986. My biography and a brochure that details FADA's operational structure including senior management qualifications is found in Exhibit A.

While the FADA was initially capitalized with \$1 million on November 5, 1985 in order to begin organization, the FSLIC capitalized the FADA on March 14, 1986 with an additional investment of \$24 million. In addition the FADA currently has a \$50 million line of credit with the Federal Home Loan Bank of Topeka guaranteed by the FSLIC for use with the management of receivership assets.

Basic legal documentation consisting of contracts between the FSLIC as Receiver or Conservator and the FADA for asset management and disposition services was completed in July, 1986; a standard contract for work with the FSLIC in its corporate capacity was completed in October, 1986. Therefore, the FADA acts as FSLIC's agent for services in three ways: 1) an asset management and disposition agreement with the FSLIC as

Receiver; 2) an asset advisory agreement with Management Consignment Program (MCP) institutions or other financially troubled institutions with the FSLIC s consent; and 3) an agreement with the FSLIC in its corporate capacity. The FADA was engaged for its first casset management and disposition assignment on July 18, 1986 with the FSLIC as receiver for Sun Savings and Loan Association San Diego, California.

As of February 27, 1987, the FADA has a staff of 199, and has established its administrative offices in San Francisco and four key offices have been located in Denver, Atlanta, Dallas, and Los Angeles. Temporary offices have also been established in West Palm Beach, Florida; Houston, Texas; and Washington, D.C. to help with current engagements.

Corporate Objectives

The FADA's goal in the management, workout, and disposition of troubled assets for the FSLIC is to obtain the highest possible price on a net present value basis. The FADA seeks to perform the asset management and disposition function at the lowest cost to the FSLIC consistent with sound business operations. The assets under FADA management are negotiated and sold within a timeframe that is consistent with obtaining the best possible value for the FSLIC. Regional economic differences are carefully assessed and strategies selected to reflect market sensitivities. The FADA strives for prudent and professional disposition strategies for these assets by producing results that increase the net realizable value to the FSLIC in a reasonable but not precipitous manner.

The FADA performs asset management and disposition services for FSLIC with a small staff of professionals who utilize specialized subcontractors as the workload demands. This "accordion approach" to subcontracting enables the FADA to minimize operating costs and utilize resources efficiently on an as needed basis without a large build up of core staff.

In many cases, the management and the disposition of assets has included the use of firms and individuals with an intimate knowledge of a particular asset type and local market. A detailed questionnaire has been designed to gather information on potential contractors and systems are being built to track and monitor their performance. Over 900 companies and individuals have contacted the FADA, with almost 65% having responded to the questionnaire. The FADA has begun to draw upon that help and presently is using over 50 companies to assist the efforts. Additionally, the FADA has had formal contact with approximately 750 individual fee appraisers expressing interest in providing appraisal services. To date, approximately 325 appraisers have responded and are in in the process of being qualified.

Seventy-five firms have been pre-screened on an urgent basis to meet the immediate needs of FADA and are in the process of being formally qualified. In addition, two national appraisal firms have been performing appraisal services for FADA on a regular basis. Other firms are being similarly solicited.

While the length of the FADA charter is 10 years, the FADA is committed to fulfilling its task in far less time through cost effective operating efficiencies and leveraging its staff and contractor resources.

Current Activities

1. Asset Management and Disposition Agreements

The FADA's goal is "...to wring out every last penny for FSLIC..." in the words of FADA's Chairman of the Board of Directors, William F. McKenna. The FADA has undertaken ten asset management and disposition agreements for FSLIC receiverships as of February 25, 1987, encompassing about 1,000 assets. The book value of these assets is nearly \$2 billion.

If 100% of the book value of all participation loans is included, the takeover value of assets under FADA management is about \$3 billion.

Simply put, the FADA has become a major FSLIC contractor for asset management. The FADA has dramatically improved the FSLIC's ability to secure the highest value on loan workouts and asset sales, and to minimize the associated management expense in the interim.

The FADA will be able to achieve these goals in part by applying the expertise of its specialists to specific asset management problems, and by operating with the greater flexibility of a private organization. Moreover, the FADA's assumption of responsibility for asset management and disposition will leave the FSLIC staff free to concentrate on forming receiverships, processing claims, supervising litigation, and formulating policy.

FADA's timely, cost-effective asset workout capability already is significantly reducing the high legal and management service fees to FSLIC from managing troubled properties while taking innovative action to maximize FSLIC's return on the sale of such assets. An example of a successful major loan workout is the recent global swap negotiated by FADA between two California savings and loans (Thrift A and Thrift B). FADI in connection with its management of Thrift A's FADA, asset portfolio, recently completed a global workout of 23 participation assets with an original book value of \$23 million between Thrifts A and B. The swap will take the second thrift out of the lead management position of these assets, allowing significantly greater ease in the management and liquidation of them. The two S&L's shares in each of the assets were equated and partial shares were "swapped" for whole assets. The high costs involved in managing a participation loan are alleviated for both parties. Substantial fees related to legal and management services have been eliminated. FADA anticipates that the deal will close in the next 30 days.

Another example of FADA's savings to the FSLIC is the settlement it negotiated in 1986 for the control and release of assets with the largest borrower of a failed California thrift. Immediately after FADA began its engagement in August, 1986, staff negotiated for the control and release of eleven assets worth \$16 million in book value. The global settlement for these assets, which include joint ventures and loans, included settlement of all litigation against FSLIC and short-term borrower buy back options. FSLIC was indemnified against further creditor claims as part of the settlement. As a result, these assets are now free and clear for sale.

Asset Advisory Engagements

The FADA can be called upon to perform work on asset portfolios or specific assets of financially troubled savings institutions. The FADA negotiated its first asset advisory services contract on August 1, 1986. The ultimate objective of the asset advisory services program is to aid the troubled institutions in minimizing losses through a professional capital recovery process.

As of February 25, 1987, 8 asset advisory engagements were in effect and two engagements had been completed. With respect to the 8 engagements currently in effect, as of February 25, there are 869 total assets under advisory contract. During the first quarter of 1987, the FADA expects 10 additional assignments.

The work performed on these assignments range from global loan workouts between the troubled institution and syndicated partnerships to the preparation of asset business plans (including disposition strategies) for a dozen non-performing construction loans in a troubled S&L's portfolio.

FSLIC Corporate Requests

In its corporate capacity, the FSLIC has asked FADA to work on several assignments that aid FSLIC in the asset management and disposition function. Two areas, for example that FADA is actively providing assistance to FSLIC are property insurance and participation loans.

In the property insurance area, there are currently three programs being utilized by the FSLIC and the FADA to control insurance cost through centralizing the review and ordering of insurance for receivership assets. The FADA, in a joint effort with FSLIC, is working to evaluate each program. Recommendations on eliminating duplicate insurance, reducing cost by securing economies of scale for each receivership and improving coverage so as to match insurance coverage precisely to individual assets will be implemented in early 1987 for the combined property insurance requirements of the receivership assets.

Participation loans are an especially troublesome asset quality problem area. These are usually loans made in dollar amounts of \$1 million or more by a single thrift institution called the lead lender, who then sells interests in or pro rata shares of the loan to other thrifts, called participants. The FADA has concentrated staff and information systems resources to untangle the nationwide web of pieces of major loans sold to thrift institutions without proper underwriting.

The FSLIC in conjunction with the 12 Federal Home Loan Banks is developing policies and procedures in dealing with and developing workout strategies for problem participation loans. The FADA has, and continues to, advise the FSLIC in this area. In addition, the FADA is assisting the FSLIC and the 12 Federal Home Loan Banks in collecting data on problem participation loans nationwide.

Portfolio Composition

While each of the ten portfolios with assets under FADA management as of February 25, 1987 have unique concentrations of problem assets, patterns of asset deterioration can be identified from the statistics taken as a whole. These statistics are based on the estimated book value as of February 25, 1987 rather than net takeover value. Charts of the following information are presented in Exhibit B.

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Asset Classification

With respect to the classification of assets by investment type, construction loans comprise 33.4% of the value of assets under FADA management. The second largest category of asset classification are loans secured by commercial real estate, with 21 2% of total value. Land loans represent 18 4% of the total. Wrap, residential, consumer, and unsecured loans represent the remaining value.

BECAUSE OVER THREE-QUARTERS OF THE NON-PERFORMING ASSETS UNDER FADA MANAGEMENT ARE LOANS, EXTENSIVE NEGOTIATIONS HAVE BEEN UNDERTAKEN WITH BORROWERS TO ACHIEVE CAPITAL AND INTEREST RECOVERIES FOR THE RECEIVERSHIPS AS AN OPERATING FORMAT, THE MOST SIGNIFICANT OF THESE NEGOTIATIONS HAVE BEEN UNDERTAKEN BY FADA PERSONNEL, THEREBY EFFECTIVELY AND MATERIALLY REDUCING THE ASSET MANAGEMENT COSTS FOR THESE ASSETS.

Property Type

The property types of assets under FADA management can be segmented into key categories as well, as of February 25, 1987. 27% of the asset values are improved and unimproved commercial and residential land. The second largest category of property type is office property with 15.9% of value, followed closely by residential property, representing 15.5% of value. Retail represents 10.7%, while mixed-use development property comprises nearly 10% of value.

Apartment is 8.6%, hotel and restaurant is 4%, industrial is 2.1%, and miscellaneous other properties comprise the remaining property types. In summary, the non-performing portfolios are largely real estate related and reflect a large number of investments in projects and new lines of commercial development businesses. They are far removed from home lending practices of the majority of savings institutions.

Geographic Area

Three states: Texas, Florida, and California are locations for over 74% of the assets under FADA management. Forty-two percent of the value and 18.8% of the assets are in Texas. Florida assets are almost one-quarter of portfolio value and number of total assets. Assets in California represent 8.3% of total assets value but represent 19.3% of the number of assets. Arkansas assets represent 4.1% of the value and 7.8% of the total number of assets. Thus, as of

February 25, 1987, nearly all of the non-performing assets under FADA management are located in the sun and oil belts across America. Over the next few years these percentages will change, but the FADA anticipates that the states of California, Texas and Florida will continue to dominate the picture.

II. 1987 OUTLOOK

During 1986, the FADA has organized so that it is poised to assist the FSLIC under a recapitalization plan with expanded asset management and disposition advice and services as needed in the future. A sound operational infrastructure combined with a well developed, elastic supply of contractors will make this possible.

The FADA will focus its efforts on several key strategic issues in 1987: (1) management and marketing performance; (2) refinement and expansion of asset systems; (3) legal coordination, and (4) responsiveness to FSLIC restructuring efforts.

First, creative management and marketing strategies will be implemented as more volume develops in particular geographic areas and property types. The individual portfolios, for example, may have concentrations of condominium units in one locale within a state that might be readily packaged and marketed together.

Second, behind all of these efforts, superior systems capability undergird the FADA s objective to minimize cost and maximize value in the asset management and disposition function. In 1987, the FADA will monitor, test, and modify key systems in the participation loan, appraisal, property insurance, contractor, and asset business plan arenas. The FADA will continue to coordinate systems development and implementation with the FHLBB and Bank System-related entities so that data collected can be exchanged as appropriate.

Third, legal process issues will continue to be critical in enabling the FADA to develop successful workout strategies and sell the assets under management on schedules driven by sound business operation and not the complexities and delays of court processes. In order to minimize the number and cost of law suits, and ensure timely disposition of assets, the FADA will need to work more closely with the receivers and FHLBB.

Fourth, as noted by FHLBB Chairman Gray in his testimony before this Subcommittee on January 22, 1987, a Bank Board task force is devising plans and procedures to restructure the FSLIC that includes making the best, high quality use of the FADA's expertise in the asset management and disposition process. The FADA is assisting the Bank Board's efforts and will implement resulting recommendations in 1987.

Capital Recovery Estimates

The area where the FADA can be of the most "added value" to the system is in the area of "capital recovery" relative to the disposition of assets for the FSLIC. Capital recovery is and will continue to be one of the key areas of the FADA s focus For illustrative purposes, for each 10% improvement on \$100 million of FADA managed assets, a \$10 million benefit would be realized for the FSLIC.

As an example, during the third quarter of 1986, the FSLIC asked the FADA to manage three major portfolios. These portfolios emanated from the Sun, Presidio and Sunrise Receiverships. To date, progress on these portfolios has been encouraging.

Based on the most recent FADA analysis of the total portfolios, a 90% +/- recovery rate is anticipated. However, when the combined portfolios are examined, it must be recognized that many of the markets in which these assets are located are extremely volatile and that future economic changes could cause significant fluctuations in asset values which in turn would influence recovery

NON-PERFORMING ASSETS: OBSERVATIONS AND LESSONS LEARNED

What has the FADA learned to date about the causes of asset quality problems and the mistakes made by thrift industry managers?

Four problem areas are clearly evident to us as asset managers: (1) poor or nonexistent underwriting procedures, (2) problem participation loans, (3) lack of management systems, and (4) fraud.

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1. Underwriting Process

Underwriting procedures were poor or nonexistent particularly when loans were made by thrift managers lacking knowledge and experience in new lines of businesses. Such loans were often made on property types that thrift directors and managers were not familiar with. Projects were funded in geographic areas where they did not know the local real estate markets. Finally, thrift lenders have often failed to properly address borrower quality and credit worthiness.

Frequently we have found a lack of good appraisals. Quality is the issue here, not a lack of appraisals. Overvalued properties result from appraisers being hired and taking orders from the borrower, not the thrift lender.

In these cases, I am speaking of the lack of knowledge by thrift directors and managers, particularly in acquisition, development, and construction (ADC) loan lending.

2. Problem Participation Loans

<u>Participation loans</u> are a particularly thorny problem because participating thrift institutions have frequently failed to obtain proper documentation from lead lenders; neglected to physically inspect the property; and have failed to understand the role of the lead lender as loan underwriter.

We have found what are, in effect, networks of the same institutions participating in deals that have gone sour. Patterns of lead lenders and participating institutions have emerged and we will be tracking problem participation loans on a data base that we are creating for the FSLIC and the Federal Home Loan Bank System.

Management Systems

Institutions have failed to put in place appropriate <u>systems</u> that provide thrift managers and directors with effective underwriting tools. Thrift managers need automated information that provides early warning of loan problems, and reports on loan accounting, delinquencies, and property insurance. Poor systems contribute to the lack of knowledge of property types and geographic markets To solve asset quality problems, one needs to identify the magnitude and details of those problems.

4. Fraud

<u>Fraud</u>, which is impossible to stop altogether, is a frequent companion to asset quality problems. We see example after example of construction loans in receivershipe which were most often derailed by fraud.

IV. THE EFFECTS OF H.R. 27 ON FADA

The FADA supports the objective of Congress in Section 7 of H.R. 27 a bill to recapitalize the FSLIC, as stated in Chairman St Germain s January 6, 1987 Floor statement that calls for a "full audit and review by the General Accounting Office" of the FADA. The Chairman s Floor statement further states that Section 7 "is designed to assure that there is thorough accountability for the billions of dollars of assets acquired and sold by FADA as a result of savings and loan failures."

The FADA has carefully studied the language of Section 7 and, while supporting Congressional intent, we have several concerns, clarifications, and suggested modifications that are divided into three areas: (1) GAO audit and review provisions, (2) Sunshine Act provisions, and (3) reporting requirements.

GAO Audit and Review

Section 7 of H.R. 27 is drafted to assure full audit and review by GAO. The FADA supports this objective. In fact, the GAO has conducted

three reviews of various FADA operations in recent months. These reviews were coordinated through the FSLIC in a full and open manner.

The FADA was chartered by the FHLBB as a Federal Savings and Loan Association and, pursuant to FHLBB regulations (12 CFR 563.17-1(a)(2)), the FADA is subject to audit requirements for federal savings and loan associations and has engaged the national accounting firm of Peat, Marwick and Mitchell to conduct audits of FADA.

The current bill language, however, achieves the stated objective in a manner that goes well beyond GAO audit and review by making FADA a mixed-ownership Government Corporation. The implications of applying this extremely broad based Government Corporation status on FADA may well effectively erode its ability to achieve the highest values for the FSLIC for troubled real estate assets.

One result of the current language may be to apply Gramm-Rudman-Hollings sequestration provisions to FADA as well as the possible assertion of authority over FADA by the Office of Management and Budget. As you are well aware, the Federal Deposit Insurance Corporation (FDIC), which is a mixed-ownership Government Corporation, has recently faced both of these issues. We do not believe this to be Congressional intent.

A modification would subject FADA to audit by the GAO on demand. In this way, the Congress would have maximum flexibility to examine all operations of FADA as it deems necessary and appropriate. The Congress will achieve its objective of GAO oversight and still enable the FADA to perform its asset management and disposition functions effectively.

with respect to Congressional congerns about accountability. FADA is specifically prohibited by its bylaws from taking title to these troubled assets or borrowing money in the capital markets.

Let me emphasis and clarify the Chairman's Floor statement because the FADA does <u>not</u> acquire assets from the FSLIC; the FSLIC retains title to these assets.

Sunshine Act

While the FADA understands and supports the underpinnings of the open meeting requirement of the Government in Sunshine Act, we believe that such a provision would, in fact, severely restrict and inhibit the ability of FADA management and Board of Directors to perform its asset management and disposition duties. The Board of Directors openly and candidly discusses the relative strengths and weaknesses of various troubled savings institutions and real estate markets. If these discussions become public, the ability of the FADA to obtain the highest value for troubled real estate assets would plummet Moreover public confidence in the safety and soundness of the savings and loan system would be severely shaken This would have a devastating effect on local communities if runs on thrift institution deposits occurred.

In a letter to Chairman St Germain dated January 28, 1987 which I have included as Exhibit C, FADA Board Member and former FHLBB Chairman, Thomas R. Bomar, succinctly described FADA's dilemma with respect to the Sunshine Act provision:

"The provision for having FADA subject to the "Sunshine" law is potentially very damaging. All of us are in accord with the objectives of the Sunshine law. No group of elected or appointed officials has any business doing the public's business in secret.

FADA's mission is very straightforward. FADA was organized to deal with bad assets coming out of defunct S&L's. These assets are typically a mess legally, as well as their inherent makeup, e.g., a housing development poorly designed, poorly located, improperly built in which lender and borrower may have been partners of some

form and it appears there may have been fraud involved at every step of the transaction. The complexity of these dealings is such that handling them within the confines of a government bureaucracy is almost certain to increase the cost of the solution perhaps by a major multiple amount.

FADA is not making any rules or approving any applications or in any way engaging in any other public business of that type. It is simply trying to work out legally and operationally complex business transactions to recover a maximum amount of money and cut FSLIC's losses.

To open this process of borrower negotiation, private legal proceedings, building trade negotiations, sales efforts and so forth to a public forum will stifle most of FADA's potential."

We, therefore, strongly endorse deleting this provision of Section 7.

3. Reporting Requirements

H.R. 27 includes a provision requiring quarterly detailed written reports to the House and Senate Banking Committees on all FADA activities and operations.

The reporting requirements of section 7 are, in effect, duplicative since the FADA has a required financial and operational reporting requirement to the FSLIC, its sole shareholder. The Congress and GAO has access to this and other information through the FSLIC at any time. The regulatory structure that the FHLBB and the FSLIC have established for the FADA should be allowed to continue and a separate provision to be audited by GAO in conjunction with already existing reporting requirements would accomplish the objectives outlined by Chairman St Germain in his Floor statement.

In addition, H.R. 27 currently contains a similar reporting requirement in Section 6(e) that requires FADA to report on the full scope of its activities and operations as part of a broader report to the Congress by the FSLIC.

For these reasons, this provision, therefore, can be deleted and the reporting requirements of Section 6(e) substituted.

nummary, given the magnitude of troubled real estate assets that and future savings and loan failures, we believe the cof FADA can substantially help the Congress and the FSLIC live these probleme. We support your objectives of the FADA lucting its operations and activities under full pressional scrutiny and, in achieving this purpose, sincerely a you will give serious consideration to the modifications we suggested.

EXHIBIT A

ROSLYN B. PAYNE - BIO

Roslyn B. Payne is President and CEO of the Federal Asset
Disposition Association, a wholly subsidiary of the FSLIC. The
Federal Asset Disposition Association was created in late 1985
to handle the management, work-out and liquidation of the
significant number of difficult assets encountered by FSLIC
through the failure of savings institutions. The FADA acts as
an agent for FSLIC.

Prior to her current responsibilities, Mrs. Payne was an executive with Genstar. She was President of Genstar Pacific Development Ventures, a real estate investment company involved with residential and commercial developments. She was also a Group Vice President for the Land and Real Estate Division of Genstar Corporation, a board member and Executive Vice President and General Manager of Sutter Hill Ltd., a Genstar commercial development company. She had originally joined Genstar Mortgage Company in November 1981 as Senior Vice President.

Before joining Genstar, she was a Vice President and shareholder with Eastdil Realty Inc., a real estate investment banking firm. Mrs. Payne was with Eastdil from 1970 to 1981 in New York and San Francisco.

Mrs. Payne is a former member of the Board of Directors of the Financial Center Bank, San Francisco, California and is a Board Member of First American Title Guaranty Company, Oakland, California. She is on the Board of Directors of the Northern California Chapter of Lambda Alpha, a real estate honorary, and is a member of the Visiting Committee of the School of Business Administration of the University of Michigan. Mrs. Payne was President of the Bay Area Mortgage Association 1981 - 1982.

She received a bachelor of business degree from the University of Michigan 1968 and a master's in business administration from the Harvard Business School in 1970.

THE FEDERAL ASSET DISPOSITION ASSOCIATION

Background

Since the early 1980's the Federal Savings and Loan Insurance Corporation (FSLIC) has been experiencing a new dilemma: what to do with the non performing cases of inancially toubled savings and loan componies. In the touth quarter of 1985, the Federal Home Loan Bank Board created the Federal Asset Disposition Association (FADA) to aggressively manage these non performing assets, workout the problems they have and effectively dispose of them.

Purpose

The sole purpose of the Federal Asset Disposition Association is to assist in strengthening the financial health of the FSLIC by using private sector management and marketing techniques to manage non performing assets in the FSLIC system at the lowest cost consistent with sound operations and to sell these assets as fast as is consistent with obtaining the best possible return for the FSLIC and its receiveships.

Operations

FADA has committed to fulfilling this task in far less than the 10 years allowed in the chaster. FADA believes it can successfully accomplish the objectives and disband the arganization. Successfully shiflling these objectives, FADA will have made a significant contribution to restoring strength to this segment of the nation's financial system.

FADA was formed as a private Federally chartered savings and loan association pursuant to section 406 of the National Housing Act of 1934 to be able to operate with the entrepreneural spirit and operational efficiencies of the private market. This is believed the most effective way to fulfill the company's goals.

FADA's management team is comprised of highly skilled real estate professionals who have brought with them a broad range of experience in many disciplines. Assembled is a group that includes asset and property manages, administration, as well as accountants and darta processing experts. Manages have come to FADA from a number of fields including real estate development, finance, investment and management.

Another element that will contribute to FADA's success in dealing with the large quantities of difficult assets will be its oblitty to effectively utilize the services of other specialists in the local mankets in which it operates.

In many cases, the management and the disposition of assets will include the use of times and individuals with an intimate knowledge of a particular asset type and local market. Therefore, FADA must know these specialists, contract with them, and monitor their performance to ensure that the operating goals are met.

Office Locations

Real estate has tended to be a business in which local presence is essential. That was a major factor in FADA's decision to decembratise many functions and operate out of several strategically located regional offices. Each FADA office houses a regional manager who works with a group of portfolio and asset managers. In addition, most legal and operating marities are managed in FADA regional offices. However, accounting an exporting functions are centrally located at FADA's administrative offices in San Prancisco. This is intended to provide an effective means for internal control and ensures quality and consistency in the reporting of financial and operating information to FADA's shareholder, the FSLIC.

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DENVER OFFICE Empire Park IV 3801 E. Florida Avenue Suite 400 Denver, CO 80210 (303) 753-0888

DALLAS OFFICE 5080 Spectrum Drive Suite 1100E Dailos, TX 75248 (214) 960-8766

LOS ANGELES OFFICE 333 South Hope Suite 3600 Los Angeles, CA 90071 (213) 680-9143

ATLANTA OFFICE 6111-D Peachtree Duriwoody Road Suite 201 Atlanta, GA 30328 (404) 393-8400

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THE FEDERAL ASSET DISPOSITION ASSOCIATION Key Personnel

DSTRATIVE OFFICE

i. Raymo if cand Chief Emocutive Offices

ne brings to the Federal Asset sociation a wide range of ate knowledge gained in positions as an essecutive with Corporation: President. Pacific Development Ventures: ice President, Land and Real sion, Genstar: Board cand Executive Vice President merci Manager, Sutter Hill Senior Vice President, Genstar re Company.

joining Genster. Ms. Payne as a Vice President and ider. Eastell Realty, Inc., from 1981 both in New York and in noteco.

on to her professional positions. ne serves on the boards of the merican Title Guaranty ny, the Pinancial Center Bank. em California Chapter of r Alpha. Prom 1961 - 1962 Ms. erved as President of the Bay origage Association.

ost M.B.A., Harvard Business 1970. B.S., Business Administraiversity of Michigan, 1968.

Fice President, Beat Estate

joining the Federal Asset on Association, Mr. Lindner ployed with BA Mortgage and ional Realty Corporation, a subsidiary nerica Corporation. His most position was as Senior Vice nt responsible for ation's real estate lending s within the greater southern ia marketolace.

loss Graduate, University of and the Program for ement Development, Harvard : School.

Phillip 7. Poster Senior Vice President, Operations

Mr. Poster served as Vice President and Chief Pinancial Officer for the Crocker Mortgage Company, prior to joining the Federal Asset Disposition ine Federal Asset Disposition Association. From November 1984 to August 1985, he served as Vice President and Chief Financial Officer of the Real Estate Industries Division of Crocker National Bank.

Prior to joining Crocker. Mr. Poster was an essecutive with Wells Raspo and Company and Wells Raspo Bank for seven years. Additionally. Mr. Poster has held the position of Principal. Hellman. Hellman and Pierce. Accountants Protestional Corporation. Assistant Treasurer of Reality and Mortgage Investors of the Pacific and Senior Accountant. Peat. Marwick. Mitchell and Co.

Education M.B.A., Taxation, Golden Gate University, San Prancisco, 1980. B.A., Accounting, California State University, San Prancisco, 1969.

Robert J. Axley Senior Vice President, General Counsel and Secretary,

Before joining the Federal Asset Disposition Association, Mr. Axley served as President and Chief Operating Officer of Realty Develop-ment Corporation and its affiliated

Prior to joining Realty Development Corporation. Mr. Axiey specialized in commercial real estate law as a Partner with the Dallas law firm of Hewell, Johnson, Swanson and Borbee.

Education Graduate, University of Oklahoma College of Law, 1973. B.S., Engineering, U.S. Milliary Academy at West Point, 1965.

Ann Carol Bown Senior Vice Preside

Ms. Brown has had a private consulting Ms. stown has not a private consuming practice in strategy formulation and implementation. Clients included Coca Cola, U.S.A., ATST. New Vector Communications. The Pederal Table Commission and the Office of Management and Budget.

Prior to beginning her consulting practice, Ms. Brown was an essecutive with Wells Rago and Company for eight years, where she served as Vice President and Manager of numerous departments including, Personnel Plans and Programs, WellService Department, Credit Card Division. Earlier she served as Associate Director of Strategic Planning.

Education Ph.D., University of Rochester, 1972. B.A., summar cum knude, Newcomb College, Tukme University, 1968.

Patricia E. Esadis Vice President and Manager, Participations

Prior to joining the Federal Asset Disposition Association. Ms. Keadle was employed with Consolidated Capital Equities Corporation. Emeryville. California with her most secent position being Vice President and Manager of Mortgage Pinance Department.

Before joining Consolidated Capital, Ms. Readle served for a number of years as Vice President of Wells Pargo's Real Estate Industries Group in San

Education Graduate, Pacific Coast School of Banking of the University of Washington, 1978. Certification in Real Estate, City College of San Prancisco,

Mark C. Fiumley Vice President and Director of National Marketing

In positions held prior to joining the Redecid Asset Disposition Association. Mr. Phumley served as Chief Pinancial Officer of Sutter Hill Limited, a commercial development subsidiary of Genstar Corporation: Controller of Sunderhaus and Leigh Properties: Manager. Planning and Analysis. Sutter Hill Limited: Supervisor. Interior Accountant, Peat, Marwick, Mitchell & Co.

Education California Certified Public Accountant, 1981. B.S., Business Administration, summa cum laude. San Francisco State University, 1978.

John J. Hecty, Jr. MAI/CEE, Vice President, Director of Valuation Services

Before joining the Rederal Asset Disposition Association, Mr. Healty was Senior Vice President and Director of Valuation Services for BA Appealsals, Inc.

Prior to joining BA Appraisals, Mr. Heatly served as Vice President and Assistant Officer in charge of the Appraisal. Architectural and Engineering Section of Manufactures: Honover Trust Company.

Education M.B.A.. Finance. Investments and Banking, Hoistra University, Hempstead, N.Y., 1977.

Paul R. Samber Vice President and Director of Ruman Resources

Prior to joining the Federal Asset Disposition Association, Mr. Bardset served as Vice President and Manager of Petronnel and Employee Relations for the Corporate Banking Group of Wells Pago Bank in San Francisco, CA.

Prior to joining Wells Rungo, Mr. Burber served in numerous capacities in the human relations arena from 1968 -1979 at Pint Intentate Bank in San Prancisco.

in addition to his professional position.

Mr. Barber is a member of the

American Society for Personnel

Administration.

Education B.S., Finance, University of Utah, 1968.

REGIONAL OFFICES

John Batfield Vice President and Regional Manager, Atlanta

Before joining the Federal Asset Disposition Association, Mr. Haitleid served as President of GSF Properties, Inc. and President of Jetierson investment Company, both of Atlanta.

Before serving in the atcrementioned capacities, Mr. Hattleid was Vice President of Acquisitions, Southeast Regional, for First Capital Corporation of Atlanta.

Education M.B.A., Finance, Georgia State University, Atlania, Georgia, 1975. B.A., History, Latayette College, Easton, Pennsylvania, 1967.

Donald J. Watts Vice President and Regional Manager, Los Angeles

Prior to joining the Federal Asset Disposition Association, from 1984 to 1986. Mr. Watts was Senior Vice President of Real Estate Finance for Crocker National Brank in Los Angeles. Before working with Crocker, Mr. Watts was employed as Vice President/Manager of the Real Estate Industries Group of Wells Pargo Bank in Los Angeles.

Education B.S., Finance, St. Joseph's College, Philadelphia, Pennsylvania, 1976.

David R. Williams Vice President and Regional Manager, Dallas

Mr. Williams joined the Pederal Asset Disposition Association upon his departure from BA Mortgage & International Realty Corporation where he served as Pestdent of the Texas Division. Before joining BA Mortgage in 1979, Mr. Williams served as a Project Administrator for Las Colinas Corporation. He has also had prior experience as controller and Project Manager for TangleWood-on-Texanona, Inc., a large scale residential and commercial development.

Education Graduate Coursework, Texas Tech University, 1966-1967. B.S. Personnel Management and Accounting, Texas Tech University, 1966.

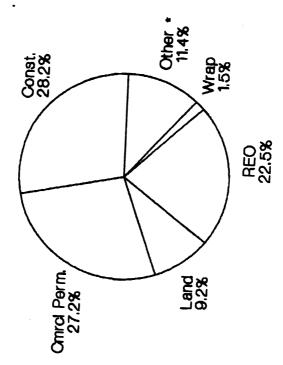
David W. Gustation Asset Manager, Denver, Colorado

Prior to joining the Federal Asset Disposition Association. Mr. Guistation served as Vice President, Acquisitions for Century Partners in Deriver and as Senior Investment Analyst for Century in Sam Motieo. Positions held before joining Century include Chief Administrative Officer for Hibermian Properties Corporation of Deniver and Administrator for U.S. Department of Housing and Urban Development.

Education B.A., Brown University, Providence, Rhode Island, 1969.

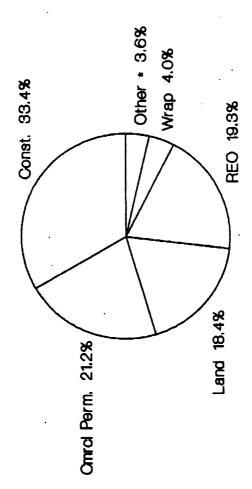
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FEDERAL ASSET DISPOSITION ASSOCIATION Total Receiverships as of 2-25-87 Number of Assets by Asset Classification



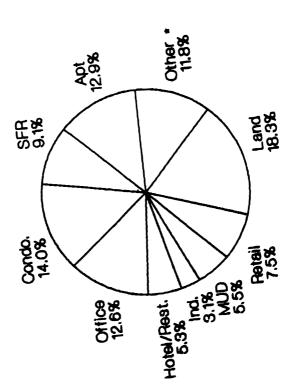
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FEDERAL ASSET DISPOSITION ASSOCIATION Total Receiverships as of 2-25-87 Value of Assets by Asset Classification



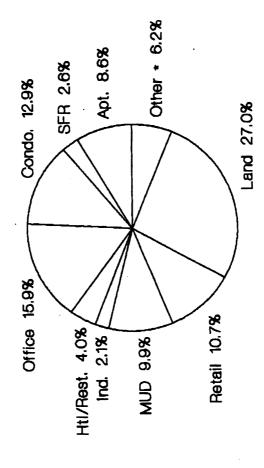
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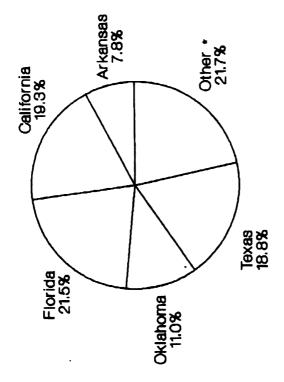


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FEDERAL ASSET DISPOSITION ASSOCIATION Total Receiverships as of 2-25-87 Value of Assets by Property Type

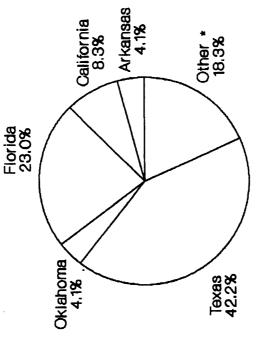


 includes Lessehold, Non Resi Property, Other Resi Property, Timeshere/PUD, Sn Not Available.



Includes AZ, CO, GA, Hi, IL, KS, KY,
 LA, MD, MS, NJ, NM, NY, NY, OR, 3C, TN
 UT, VA, WY, and Not Aediable.

FEDERAL ASSET DISPOSITION ASSOCIATION Total Receiverships as of 2-25-87 value of Assets by Geographic Area



• Indudes AZ, CO, GA, HI, IL, KB, KY, LA, MD, MS, NJ, NM, NY, OY, OR, BC, TN, UT, W, WY, end Not Available.

EXHIBIT C



January 28, 1987

The Honorable Pernand J. St Germain, Chairman House Banking, Pinance and Urban Affairs Committee Room 2129, Rayburn House Office Building Washington, D.C. 20515

Dear Chairman St Germain:

SUBJECT: 1.R. 27

Your Pinancial Institutions SubCommittee is presently giving consideration to a new bill, H.R. 27. Contained in Section Seven (7) of this bill are provisions dealing with the Pederal Asset Disposition Association (PADA).

Section Seven would subject PADA to GAO audit.

Section Seven would define FADA as a mixed ownership government corporation.

Section Seven would subject FADA to the Government in Sunshine $\mbox{\bf Act}\,.$

I am a director of PADA, serving with a group of other savings and loan associations' chief executive officers, after having been one of the organizers of PADA. For this reason, as well as AmeriFirst being a payer of substantial premium dollars to the Pederal Savings & Loan Insurance Corporation, we have a major interest in your bill.

PADA is a federally chartered S&L, subjected to all the requirements of all federally chartered S&L's. There seems to be no good reason to have GAO audit PADA. However, if that is thought desirable, it is of no particular consequence other than to cost PADA a little extra time and trouble dealing with another set of auditors.

I am unsure as to what significance there is in saying that PADA is a mixed-ownership government corporation. It is a mutual S&L. It was organized by a group of private individuals acting at the request of the PHLBB, but all the money put into it is PSLIC funds and Federal Home Loan Bank borrowings. That does make its status somewhat unique.

C-1

(305) 387-6000

The Honorable Pernand J. St Germain 1/28/87 Page 2

The provision of having PADA subject to the "Sunshine" law is potentially very damaging. All of us are in accord with the objectives of the Sunshine law. No group of elected or appointed officials has any business doing the public's business in secret.

PADA's mission is very straightforward. PADA was organized to deal with bad assets coming out of defunct S&L's. These assets are typically a mess legally, as well as their inherent makeup, e.g., a housing development poorly designed, poorly located, improperly built in which lender and borrower may have been partners of some form and it appears there may have been fraud involved at every step of the transaction. The complexity of these dealings is such that handling them within the confines of a government bureaucracy is almost certain to increase the cost of the solution perhaps by a major multiple amount.

PADA is a private organization under the direction of a group of people with direct experience dealing with problem assets. The PADA staff is comprised of people who have experience in working out problem assets.

PADA is not making any rules or approving any applications or in any way engaging in any other public business of that type. It is simply trying to work out legally and operationally complex business transactions to recover a maximum amount of money and cut FSLIC's losses.

To open this process of borrower negotiation, private legal proceedings, building trade negotiations, sales efforts and so forth to a public forum will stifle most of FADA's potential.

There being no public benefit to disrupting PADA's operations and much damage potential by so doing, I respectfully suggest that you delete this requirement.

As so much money is involved and it is PSLIC money and ultimately there may be tax dollars involved, especially if PADA is not as successful as it might be, having PADA reviewed by a Congressional oversight committee would be much in order.

The Monorable Pernand J. St Germain 1/28/87 Page 3

The savings and loan industry and PSLIC problem is of a magnitude not fully comprehended by a great many people. I urge you to use your best effort to work toward effective mechanics to produce a solution.

Sincerely,

Thomas F. Bomar Chairman

TRB/la

TESTIMONY HEARINGS BY THE HOUSE OF REPRESENTATIVES BANKING COMMITTEE MARCH 3, 1987

CHAIRMAN ST. GERMAIN; COMMITTEE MEMBERS:

MY NAME IS LIONEL NOWOTNY. I AM EMPLOYED AS THE PRESIDENT OF THE WATSON&TAYLOR REALTY COMPANY, WHICH HAS ITS MAIN OFFICE IN DALLAS, TEXAS. MY COMPANY IS ENGAGED IN THE COMMERCIAL REAL ESTATE BUSINESS, ACQUIRING RAW LAND AND THEN INCREASING ITS ECONOMIC VALUE BY EXECUTING THE MANY STEPS IN THE DEVELOPMENT PROCESS INCLUDING ZONING, RECLAMATION OF FLOOD PLAIN, MASTER PLANNING, DEVELOPMENT OF THOROUGHFARES AND UTILITIES AND FINALLY CONSTRUCTION OF INCOME PRODUCING ASSETS. MY COMPANY HAS A PORTFOLIO ESTIMATED AT APPROXIMATELY \$500 MILLION. WE ENGAGE IN DIRECT SALES OF ALL TYPES OF PROPERTY AS WELL AS PRIVATE AND PUBLIC SYNDICATIONS. OUR FIRM IS THE FOURTH LARGEST OPERATOR OF MINI-WAREHOUSE FACILITIES IN THE UNITED STATES.

IN YOUR CORRESPONDENCE OF FEBRUARY 26, 1987, YOU INVITED ME TO APPEAR BEFORE THIS COMMITTEE TO SHARE MY COMPANY'S EXPERIENCE AS IT APPLIES TO THE ISSUES NOW UNDER YOUR CONSIDERATION. SPECIFICALLY, I WAS ASKED TO SUMMARIZE MY EXPERIENCE IN DEALING WITH THE FSLIC AND THE FEDERAL ASSET DISPOSITION ASSOCIATION AND TO MAKE RECOMMENDATIONS CONCERNING STEPS THAT SHOULD BE TAKEN TO PROMOTE THE STABILITY AND THE RECOVERY OF THE SAVINGS AND LOAN INDUSTRY, PARTICULARLY IN THOSE AREAS EXPERIENCING SEVERE ECONOMIC DECLINE.

FIRST, I WILL COMMENT ON MY EXPERIENCE IN DEALING WITH THE FSLIC AND THE FADA. THIS EXPERIENCE HAS COME THROUGH CONTINUING RELATIONSHIPS WITH FOUR SAVINGS AND LOAN ASSOCIATIONS WHICH HAVE BEEN PLACED UNDER SUPERVISION. ONE OF THESE, WAS SUBSEQUENTLY PLACED INTO RECEIVERSHIP. I WILL LIMIT MY COMMENTS TO EXPERIENCES WITH THE ASSOCIATION IN RECEIVERSHIP.

FOR FOUR AND ONE-HALF MONTHS PRIOR TO THE ASSOCIATIONS BEING PLACED IN CEIVERSHIP, MY COMPANY HAD BEEN NEGOTIATING ITS LOAN PORTFOLIO WITH E ASSOCIATION WHILE IT WAS UNDER SUPERVISION. NEGOTIATIONS WERE NEGOTIATION WHILE IT WAS UNDER SUPERVISION. NEGOTIATIONS WERE NEGOTIATION BANK DIRECTION. THESE NEGOTIATIONS RESULTED IN THE EPARATION OF A LETTER AGREEMENT ON DISPOSITION OF THE PORTFOLIO WHICH WAS BE SIGNED DURING THE SAME WEEK IN WHICH THE ASSOCIATION WAS PLACED INTO CEIVERSHIP.

SHORTLY AFTER THE ASSOCIATION'S TAKEOVER BY THE FHLB, MY COMPANY MET TH FADA IN THEIR DALLAS OFFICES, AT WHICH TIME FADA WAS INFORMED THAT A NTATIVE AGREEMENT EXISTED WHICH HAD BEEN CAREFULLY STRUCTURED BY APPROVED PERVISORY CONSULTANTS WITH FHLB KNOWLEDGE AND COULD BE IMMEDIATELY PLEMENTED. THE SUBSTANTIAL NEGATIVE IMPACT OF DELAY ON THE COMPANY'S ILITY TO CONDUCT ITS BUSINESS WAS EMPHASIZED, ADDITIONALLY, THE SNIFICANT SIZE OF THE TOTAL LAND PORTFOLIO OWNED AND THE POTENTIAL FOR RIOUS FINANCIAL REPURCUSSIONS THROUGHOUT THE FINANCIAL COMMUNITY WAS RESSED AS ANOTHER COMPELLING MOTIVATION FOR TIMELY ACTION. DICATED THAT IT DID NOT YET HAVE RECORDS, THE COMPANY VOLUNTEERED TO PPLY FADA WITH COPIES OF ALL LOAN DOCUMENTS ON THE PORTFOLIO, AND TO HOLD TAILED BRIEFINGS FOR THEIR STAFF ON EACH INDIVIDUAL PROJECT TO EXPEDITE E NEGOTIATIONS. COMPLETE FILES WERE DELIVERED TWO DAYS FOLLOWING OUR ITIAL MEETING. ON THE NEXT DAY OUR CONCERNS WERE REITERATED AND A FIRST INT WORKING SESSION WAS ANTICIPATED DURING THE FOLLOWING WEEK AS HAD BEEN REED AT THE PREVIOUS MEETING. THAT WORKING SESSION WAS CANCELLED BY DA.

More than two months passed from the time of receivership until a meeting was called by FADA. The meeting was attended with the expectation of hearing the FADA response to the proposal that had been in hand for over two months. Upon arrival at the meeting, FADA representatives stated that the purpose of the meeting was to say that the previous proposal which had been recommended by FHLB- approved consultants was of no value, that obligations to a superior lienholder would not be paid, and that FADA now had an urgent need for a new proposed disposition agreement. No response was offered on any points of the earlier proposal and no suggestions were offered on the structure desired in the new proposal other than an indication that approval of the receiver would not be likely without the injection of cash by the borrower, but that this was not a rigid regulirement.

TWELVE DAYS LATER, HAVING RECEIVED NO FURTHER INPUT FROM FADA, ANOTHER PROPOSAL WAS DELIVERED TO FADA. THE FOLLOWING DAY FADA STATED THAT THE NEW PROPOSAL WAS NOT ACCEPTABLE. AGAIN, FADA REPRESENTATIVES DECLINED TO MAKE A COUNTER PROPOSAL. NINE DAYS LATER A LETTER WAS DELIVERED BY FADA TO MY OFFICES WHICH STATED CERTAIN TERMS UPON WHICH AN AGREEMENT MIGHT BE REACHED. THE LETTER HIGHLIGHTS SEVERAL PROBLEMS THAT BORROWERS ARE EXPERIENCING IN DEALING WITH FSLIC AND FADA IN A DEPRESSED ECONOMY. LET ME CITE CERTAIN EXCERPTS FROM THIS LETTER.

I QUOTE, "THIS LETTER WILL SET FORTH CERTAIN OF OUR CONCERNS WITH RESPECT TO SAID PROPOSAL AND WILL ALSO SET FORTH IN A <u>VERY GENERAL</u> SENSE A <u>PRELIMINARY</u> BASIS ON WHICH WE WOULD BE WILLING TO DISCUSS A WORKOUT OF THESE LOANS". MEMBERS OF THIS COMMITTEE, LET ME TELL YOU THAT IT HAS TAKE TWO AND ONE-HALF MONTHS TO REACH THIS MILESTONE. AT THIS RATE, OUR COMPANAMENTRY BEFORE AN ACTUAL AGREEMENT COULD BE ACHIEVED.

I GUOTE AGAIN, "ANY WORKOUT WHICH WE WOULD AGREE TO WOULD REQUIRE THE APPROVAL OF THE FSLIC"; "WE CANNOT ENTER INTO ANY BINDING AGREEMENTS UNTIL SUCH AGREEMENTS HAVE BEEN APPROVED BY THE RECEIVER". SINCE THE BORROWER MUST DEAL WITH AN ENTITY WHICH DOES NOT HAVE DECISION MAKING AUTHORITY THE PROCESS IS EVEN MORE CUMBERSOME AND TIME CONSUMING. IN AT LEAST ONE INSTANCE WE ARE AWARE OF, FADA'S RECOMMENDATION TO THE RECEIVER TO HONOR A FUNDING OBLIGATION TO A SUPERIOR LIENHOLDER HAS BEEN DENIED AND HAS RESULTED IN THE FORECLOSURE TODAY OF A LOAN ON WHICH APPROXIMATELY \$16 MILLION IN SUBORDINATE DEBT WILL BE UNRECOVERABLE BY THE RECEIVER.

I FURTHER QUOTE FROM THE SAME LETTER, THE COMPANY "LOOKS TO THE RECEIVER TO BEAR ALL FUTURE FINANCIAL RESPONSIBILITY AND GIVE W&T AN EXTENDED PERIOD OF TIME TO ALLOW THE PROBLEMS WITH THE PROPERTIES SECURING THE LOANS TO WORK THEMSELVES OUT. AS I AM SURE YOU ARE AWARE, THIS GIVES THE RECEIVER LITTLE INCENTIVE TO ACCEPT YOUR PROPOSAL".

GENTLEMEN, WHEN THESE LOANS WERE MADE, THE LENDER WAS PLEASED TO BEAR THE FINANCIAL RESPONSIBILITY TO EXTRACT THE REWARDS IN THE FORM OF FIFTY PERCENT PROFIT PARTICIPATIONS EXPECTED UPON DISPOSITION OF THE ASSETS. NOW THAT THE ECONOMIC SITUATION IS LESS FAVORABLE THE LENDERS, BY BEING SUBJECTED TO SEVERE CHANGES IN REGULATORY PRACTICES, HAVE BEEN FORCED TO DEMAND RENEWAL TERMS UPON WHICH MOST BORROWERS WOULD NOT HAVE BEEN ABLE TO MAKE THE INITIAL LOAN. UNDER THE CURRENT CIRCUMSTANCES TIME AND FOREBEARANCE ARE THE ONLY MEANS OF REALIZING THE MAXIMUM RETURN FROM THESE LOANS, YET THIS PROVIDES THE FSLIC "LITTLE INCENTIVE" TO COOPERATE.

TO DATE, OVER TWO AND ONE-HALF MONTHS HAVE PASSED SINCE MY FIRST MEETING WITH FADA. DURING THAT TIME FADA HAS DEMONSTRATED A DISTINCT LACK OF REGARD FOR ANY OF THE CONCERNS EXPRESSED AT OUR INITIAL MEETING. FAMILIARIZATION BRIEFINGS ON ASSETS IN THE PORTFOLIO HAVE BEEN REFUSED. FADA FAILED TO MAKE FULFILL ITS OBLIGATIONS TO FUND PAYMENTS TO SUPERIOR

LIENHOLDERS. WHILE FADA HAS STATED THE POSITION THAT THE DEBTOR IS THE OWNER OF THE PROPERTIES, IT HAS REFUSED IT THE OPPORTUNITY TO REDUCE DEBT BY DENYING CONSENT TO A CONTRACTED SALE AND HAS NOT ALLOWED IT TO REVIEW AN APPRAISAL ORDERED BY FADA ON ANOTHER PROPERTY.

SPECIFICALLY, A CONTRACT WAS PRESENTED ON ONE PROPERTY WHICH WOULD HAVE RESULTED IN A PAYDOWN EQUAL TO 110% OF THE PRORATED DEBT BASIS OF THE PARCEL TO BE RELEASED. IN SPITE OF THE FACT THAT RELEASE PROVISIONS OF THE LOAN DOCUMENTS STATE THAT THE LENDER WILL RELEASE PORTIONS OF THE PROPERTY UPON PAYMENT OF "AMOUNTS REASONABLY RELATED TO THE COLLATERAL VALUE" OF THE PARCEL TO BE RELEASED, THIS SALE WAS DENIED.

WITH REGARD TO DENYING THE OPPORTUNITY TO PARTICIPATE IN THE APPRAISAL PROCESS, FADA CONTRACTED FOR AN APPRAISAL WHICH FOUND A VALUE FOR A SECOND PROPERTY THAT IS NOT COMPATIBLE WITH KNOWN COMPARABLES IN THE IMMEDIATE NEIGHBORHOOD. FADA NEITHER ALLOWED THE BORROWER TO MEET WITH THE APPRAISER TO REVIEW ASSUMPTIONS PRIOR TO STARTING THE APPRAISAL NOR TO REVIEW THE APPRAISAL SINCE ITS COMPLETION.

Now then. What can be done to get the system back on its feet again? I suggest that if the developing situations were being looked at in a logical business-like manner we wouldn't be where we are today. The regulatory agencies have not merely oscillated, they have slammed from one extreme to the other. First, there was too much deregulation of the Savings and Loan Industry and far too little regulatory supervision. As a result, a set of lending practices was adopted by the industry which rapidly became understood to be the acceptable norm, having tacit if not explicit approval of the regulatory bodies. Then, as economic changes occurred in some regions and lenders began to experience difficulty, regulators came in and changed all of the rules for business that was

-5-

ALREADY IN PLACE. SEVERE WRITE DOWNS WERE NANDATED BY EXAMINERS CLASSIFYING LOWIS. APPRAISAL STANDARDS WERE SIGNIFICANTLY ALTERED, RESULTING IN FURTHER EROSION OF THE EQUITY BASE. LENDERS WERE TOLD NOT TO MAKE REAL ESTATE LOWIS IN CERTAIN REGIONS. THE REAL ESTATE ECONOMY CAME TO A SCREECHING HALT WITH NO WAY OUT UNDER THE EXISTING RULES.

WHAT MAKES BUSINESS SENSE IS TO: FIRST, IDENTIFY AND ELIMINATE THE CROOKS FROM THE SYSTEM, BUT RECOGNIZE THAT THE VAST MAJORITY OF LENDING INSTITUTIONS AND DEVELOPER/ BORROWERS ARE SINCERE, HONEST AND PROFESSIONAL BUSINESSMEN. THEY SHOULD BE TREATED AS SUCH. SECOND, RECOGNIZE THAT ECONOMIC CONDITIONS MAY HAVE A STRONG REGIONAL COMPONENT. A SET OF RIGID REGULATIONS CANNOT PRACTICALLY BE MADE IN WASHINGTON AND THEN APPLIED UNIFORMLY ACROSS THE COUNTRY AT ALL TIMES. SURELY, THE 12 REGIONS ESTABLISHED IN THE FHLB WERE IN RECOGNITION THAT THERE MAY BE REGIONAL DIFFERENCES WHICH WILL REQUIRE THE FLEXIBILITY TO TAKE UNIQUE ACTIONS. THIRD, RECOGNIZE THAT THE REAL ESTATE MARKET IS CYCLICAL. THE CURRENT SYSTEM OF CLASSIFYING LOANS BASED UPON APPRAISALS AND THE CHANGE IN APPRAISAL METHODS HAS CAUSED LENDERS TO SUDDENLY LOSE SUBSTANTIAL PORTIONS OF THEIR NET WORTH. AN APPRAISAL IS MERELY A "SNAPSHOT" TAKEN AT ONE POINT IN TIME IN A CYCLICAL INDUSTRY. REGULATORY PRACTICES MUST TAKE THIS CYCLE INTO ACCOUNT RATHER THAN CAUSE PANIC, RED-LINING AND FIRE SALE LIQUIDATION OF ASSETS WITH THE RESULTANT ECONOMIC CHAOS IT CAUSES, FOURTH, DON'T PUNISH HONEST LENDERS AND HONEST DEVELOPERS BECAUSE OF POOR ECONOMIC CONDITIONS - HELP THEM THROUGH THE SITUATION.

FIFTH, LEAVE ASSETS IN THE HANDS OF THOSE MOST LIKELY TO CONVERT THE ASSET INTO CASH AND PAY THE DEBT. THE DEVELOPERS ARE HIGHLY MOTIVATED BY THE DESIRE TO MAKE A PROFIT, REDUCE DEBT OR EVEN TO MINIMIZE A POTENTIAL FUTURE DEFICIENCY. NO OTHER ENTITY IS MORE MOTIVATED TO REALIZE MAXIMUM YIELD FROM THE ASSETS. CERTAINLY, THE STAFFS OF THE REGULATORY BODIES HAVE NO SUCH INCENTIVES. IN FACT THE STAFFS OF ASSOCIATIONS SUCH AS FADA HAVE AN INCENTIVE TO TAKE PROPERTY FROM THE DEVELOPERS AS SUCH ACTION PROLONGS THEIR JOB AND REQUIRES ADDITIONAL STAFFING WHICH MIGHT JUSTIFY GREATER RESPONSIBILITY AND WAGES. SIXTH, ELIMINATE THE SEVERE WRITE DOWNS ON ASSETS WHERE REASONABLE BUSINESS PLANS INDICATE THAT THE DEBT CAN BE REPAID WITH TIME. SEVENTH, ALLOW TIME FOR THE ECONOMIC CONDITIONS TO IMPROVE SO THAT THE ULTIMATE VALUE OF THE ASSETS MAY BE REALIZED.

LAST, USE ANY NEW FUNDING APPROVED BY THE CONGRESS TO HELP THE SAVINGS AND LOAN ASSOCIATIONS RATHER THAN TO DESTROY THEM.

Federal Asset Disposition Association

ADMINISTRATIVE OFFICES.
One Martiet Plaza
Spear St. Tower, 38th Floor
San Francisco, CA 94105
(415) 543-3232

March 20, 1987

The Honorable Fernand J. St Germain Chairman Committee on Banking, Finance and Urban Affairs U.S. House of Representatives Washington, D.C. 20515

Dear Mr. Chairman:

I have attached the following materials related to the very complicated restructuring negotiations involved in the Watson and Taylor loans:

- Memorandum from FADA Dallas Office identifying key problem areas of Watson and Taylor loans with Exhibit A and attachments.
- Two letters from John Scott, FADA Asset Manager, to Lionel Nowotny, dated 2/27/87.
- Letter from David Williams, FADA Regional Manager, to Starke Taylor and George Watson, dated 12/30/86.
- Letter from Lionel Nowotny to David Williams dated 2/24/87.
- Letter from Lionel Nowotny to David Williams dated 2/18/87.

Very Sinterely,

Roslyn B. Payne President and CEO

Attachments

Federal Asset Disposition Association

5080 Spectrum Drive Suite 1100 E Dallas, Texas 75248 (214) 960-8766

MEMORANDUM

The purpose of this Memorandum is to summarize the status of the above-referenced Loans and to identify several key problem areas of the existing W&TR proposals to restructure them.

A. Asset Review Schedule.

Attached as <u>Exhibit A</u> is a schedule by asset of the W&T portfolio indicating among other things, existing debt, total loan commitment, maturity dates, and asset types. The market values of collateral property being received by FADA versus loan amounts indicates substantial recovery problems.

B. Economic Problems with W&T Proposal.

As you know, W&TR proposed restructuring these Loans to achieve a payoff over a period up to seven years. This proposal (a copy of which is attached hereto as Exhibit B) is similar (but not as favorable to the Receiver) to an initial plan which W&TR had discussed with J.E. Robert Co. prior to the FirstSouth Receivership. It is the opinion of the Dallas Office of FADA that the W&T proposal is deficient from an economic perspective for several reasons including, without limitation, the following:

1. Lack of Financial Commitment. W&TR and its principals, A. Starke Taylor, III, and George S. Watson, have refused to make any commitment to invest financial resources into the projects securing the Loans. When we questioned Lionel Nowotny, President of W&TR, on this, he said (a) W&TR (the borrowing entity) had no additional financial resources, (b) Messrs. Watson and Taylor did not intend to make any personal financial commitments on these Loans, and (c) there was no reason for any entities affiliated with W&TR to obligate themselves for the debts of W&TR. In connection with this, numerous requests by FADA for current financial statements on the borrowing entity, all affiliates, and Messrs. Watson and Taylor individually have been ignored.

- 2. Reduction of Existing Financial Commitment. Currently, WaTR is a guarantor of the entire indebtedness evidenced by most of the Loans (see Exhibit A). To the extent a deficiency exists (after offsets for management fees and re-appraisal rights) with respect to the Loans at the end of the workout period, WaTR proposes a "cash flow" note to be paid to the extent possible from operational cash flows of WaTR for only one-half (1/2) of the deficiency amount. This is based upon the fact that FirstSouth originally retained a 50% profit interest in the Loans.
- 3. Limited Return to FirstSouth. Wath has made several proposals which would limit the potential return which the Receiver could realize on these Loans. First, by its concept of a "Target Amount" deficiency, the Receiver's investment accrues interest during the workout period only to the extent that the current debt exceeds the current appraised value. Therefore, upon sale of the property, the Receiver would receive no return on its investment to the extent of the existing value of the properties (it should be noted that there is no income from most of the properties to provide a current return). Second, Wath proposes a reduced interest rate on the Target Amount. Finally, if the debt is paid off by sale of properties, the Receiver is not to receive any portion of the excess proceeds from such sale(s) (this negates the profit interest to FirstSouth on most of the Loans and is in direct conflict with their reasoning on setting a mount).

WATSON & TAYLOR LOAN REVIEW

			913,677 \$28,074,686 \$164,417,342 \$161,381,000		•	161,381,000	\$164,417,342 \$161,381,000	\$28,074,686	\$69,913,677	698
RETAIL CENTER	01-Jan-89	2	NONE	181	01-Mar-84	6,936,619 16,250,000	6,936,619	•	\$5,117,879	INDEP SQUARE S.C.
CONDOMINIUMS	16-Dec-88 11-Oct-89	YES	JOINT VENTURERS (25%)	181	03-Aug-84	2,087,000	1,910,700	•	\$1,910,700	PECAN SQ. CONDOS
CV	15-Sep-86	YES	W & T REALTY	1st, 2nd, 3nd	29- Jnf -62	75,000,000	64,780,000	817,610	\$23,962,390	* FRISCO LAND
CA10	15-Jul-86 25-Hay-86	YES	** W & T REALTY	1st, 2nd, 3rd	96-Jun-86	45,000,000	42,270,023	11,018,154	831,251,869	BENT-TREE OFF PARK
LAID	30-Jun-86	YES	W & T REALTY	Ę	27- Jun-86	3,530,000	2,720,000	384,937	\$2,335,063	* DUNCAN-PERRY RD.
OF S	15-May-86	YES	V & T MANAGEMENT	11	20-Dec-85	000'699	4,250,000	81,905	\$418,095	QUAIL VALLEY J/V
ORS.	30-Jul-85	YES	W & T REALTY	11	10-Jun-86	1,950,000	9,000,000	1,012,595	\$4,127,166	KELLY BLVD TRACT
APARTMENTS	01-May-88	YES	W & T REALTY	3rd, 4th	20-Jan-87	35,550,000 16,875,000	35,550,000	14,759,485	\$20,790,515	* VINDRIDGE- VINDSCAPE II
ASSET TYPE	MATURITY	GUARANTOR DELINGUENT MATURITY	MET FIRSTSOUTH OJISTANDING FIRSTSOUTH TOTAL APPRAISED APPRAISAL ASSET MAME PRIN BALANCE L.I.P. COMMITMENT VALUE DATE LIEN POSITION GUARANTOR DELINGLENT MATURITY TYPE	LIEN POSITION	MOST RECENT APPRAISAL DATE	APPRAISED VALUE	TOTAL COMI TNENT	FIRSTSOUTH	NET FIRSTSOUTH OUTSTANDING PRIN BALANCE	ASSET NAME

* SEE ATTACHED LOAM STRUCTURE
** POSSIBLE CLAIM AGAINST MESSES. MATSOM AND TAYLOR PERSONALLY AS GUARANTOR FOR A PORTION OF THE DEBT.
*** \$1,834,000 SECURED BY INVESTOR NOTES RATHER THAM THE REAL PROPERTY.

ASSET	NOTE #	ORIGINAL COMPLETED ANCINE	04-DEC-96 RATE		FLOOR
WINDSCAPE	164735	\$14,950,000	12.50\$	SINOIA*	12.50
WINDRIDGE	164855 168345	18,000,000	12.504	*FLOATS	12.50
KELLY BLVD.	141745	6,000,000	12.00\$	*FTONTS	12 00%
QUAIL VALLEY	147785	4,250,000	12 00\$	*FTONTS	12 00\$
DUNCAN PERRY	154115	2,720,000	13.00\$	*FIGNTS	13.00\$
BENT TREE	194756 194876 141665	20,150,000 9,920,023 12,200,000	9.00 \$ 12.00 \$	*FLONGS FIXED *FLONGS	12.00
FRISCO LAND	154785 154865 168465	1,760,000 57,415,000 5,605,000	13.00 £ 13.00 £ 11.50 £	*FLONGS *FLONGS *FLONGS	33.3 28.3 28.3
PECAN SQUARE	175306 180366	1,586,700	14.00\$ 14.00\$	2007 2007 2000	
PLANO CENTER	160105 180056	3,047,730 3,888,889	13.50 \$ 6.125 \$	(2) (2) (2)	

TOTAL \$154,497,319

"Waries with Republic Bank prime, adjusted first of month.

0311-108

Trustee
Company,
Realty
& Taylor
Watson
Borrower:

Apartments
/Windridge
Windscape,
roperty:

	LENDER	LOAN AMOUNT	NET	1986 NET OPERATING INCOME	INCOME
FIRST LIEN Windscape Windridge	State Mutual Life Assurance Aetna Life Insurance	\$ 4,300,000 \$ 3,825,000		\$218,451 \$220,664 \$439,115	
SECOND LIEN Windscape Windridge	Parkway II Associates (JMB) Dallas Tollway Partners (JMB)	\$ 8,052,481 (wraps lst) \$ 9,739,382 (wraps lst)	wraps lst) wraps lst)		
THIRD LIEN Windscape Windridge	FirstSouth FirstSouth	\$14,950,000 \$18,000,000			
FOURTH LIEN Windscape Windridge	FirstSouth FirstSouth	\$ 1,200,000 \$ 1,400,000			
	First South Loan Amount Less Aggregate LIP	\$35,550,000 [14,759,485]			
	Total Principal Outstanding	\$20,790,515			

(Mateon & Taylor)	
Kelly Boulevard Partnership	Kelly Blvd.
Borrower:	Property:

TONY ANDLY	\$ 6,000.00	\$ 4,127,16
LENCER	FirstSouth	Iotal Principal Outstanding
	FIRST LIEN	

Borrower: Quail Valley J/V (Watson & Taylor)

Property: Quail Valley

\$ 4,250,000 ss: LIP 81,905

FirstSouth

FIRST LIEN

LENDER

Total Principal Outstanding \$ 4

		LOAN AMOUNT	\$ 668,020	\$2,720,000	\$3,388,020 [384,937] \$3,003,083
Watson & Taylor Realty Company, Trustee	Duncan Perry Road	LENDER	(4) Sellers	FIRSTSOUTH	Less: LIP Total Principal outstanding
Borrower:	Property:		FIRST LIEN	SECOND LIEN	

stee		IONN ANDUNT	\$ 9,920,023	20,150,000	12,200,000	11,018,154 \$31,251,869
Watson & Taylor Realty Company, Indstee	Bent Tree	IBUSK	FirstSouth	FirstSouth	FirstSouth	Less: LIP Total Principal Outstanding
Borrower:	Property:		FIRST LIEN	SECOND LIEN	THIRO LIEN	

Less: LIP Total Principal Outstanding

Trustee
Company,
r Realty
f Taylor
Watson
Borrower:

Property: Prisco Land

	IBOR	IONN ANCINT	LENDER POSITY
FIRST LIEN			
1st Senior Perticipent	1st Senior Perticipent First Texas Savings Association	\$26,000,000	45.28\$
2nd Senior Participent Guaranty Pederal	Guaranty Pederal	\$14,000,000	24.38\$
Subordinate	First South	\$17,415,000	30.34\$
	Less: Participant LIP	\$57,415,000 [457,483]	
	Total Funded	\$56,957,517	
MALLI CHOOSE	FirstSouth Lees: LIP Principal Outstanding	1,760,000 [30,692] \$ 1,729,301	
THIRD LIEN	FirstSouth Lees: LIP Principal Outstanding	\$ 5,605,000 [786,911] \$ 4,818,089	
	Aggregate Principal Outstanding: \$63,504,907	\$63,504,907	

e:\0311-1cs

*Lien Actually of Equal Digmity with Lien Securing the \$57,415,000 Loan.

900	NET OPERATING INCOME	\$46,778		
	IOAN AMOUNT	\$1,910,700	ę.	\$1,910,700
Beltway/Pecan Square Cordos	·	FirstSouth	TIES IIP	Total Principal Outstanding
Property:		FIRST LIEN		

Beltway Blvd J/V (Watson & Taylor)

Borrower:

LOAN STRUCTURE

Borrower: Plano Center Associates, Ltd. (Metson & Taylor)
Property: Independence Square Shapping Center

Federal Asset Disposition Association

5080 Spectrum Drive Suite 1100 E Dailas, Texas 75248 (214) 960-8766

February 27, 1987

Mr. Lionel J. Nowotny President WATSON & TAYLOR REALTY COMPANY 4015 Belt Line Road P.O. Box 819092 Dallas, TX 75381-9092

> Re: Proposal for workout of loans from FirstSouth, F.A., to Watson & Taylor Realty Company ("W&T") and its affiliated entities

Dear Mr. Nowotny:

We are in receipt of a letter dated February 18, 1987 pursuant to which you proposed a workout of the loans which W&T and certain of its affiliates have from FirstSouth, F.A. This letter will set forth certain of our concerns with respect to said proposal and will also set forth in a very general sense a preliminary basis on which we would be willing to discuss a workout of these loans. As you have previously been informed by us, any workout which we would agree to would require the approval of the Federal Savings & Loan Insurance Corporation solely in its capacity as Receiver for FirstSouth, F.A. (the "Receiver"). Therefore, while we think the proposal set forth below would provide a workable basis for further negotiations, we cannot enter into any binding agreements until such agreements have been approved by the Receiver.

A. COMMENTS ON WAT PROPOSAL.

Your proposal of February 18 does not provide a sound basis upon which to restructure the W&T loans. As you know, many of the loans are past due and there appears no reasonable likelihood of immediately refinancing them or selling the property which secures them at a price which would be sufficient to retire the indebtedness. In our opinion your proposal does not satisfactorily address the concerns that need to be looked at by a lender in a situation such as this. As an example, you have not made any proposals concerning W&T making any additional financal commitments, but rather W&T looks to the Receiver to bear all future financial responsibility and give W&T an

Mr. Lionel J. Nowotny Pebruary 27, 1987 Page 2

extended period of time to allow the problems with the properties securing the loans to work themselves out. As I am sure you are aware, this gives the Receiver little incentive to accept your proposal.

On a more specific level, let me address several of the problems we had with your February 18th proposal. The following do not constitute a complete list of our concerns but highlight some of the major problems we had with certain of your specific proposals.

- 1. Transfer of ownership. Your letter contemplates transferring the properties to the Receiver and/or the Federal Asset Disposition Association (the "FADA") by one of two methods, a sale of certain properties for the amount of the debt secured by them, or a deed to FADA in lieu of foreclosure with no further obligation and no deficiency claim against W&T. Neither of these proposed methods of transferring the property is satisfactory. Initially, let me make it clear that the FADA merely acts as an agent and attorney-in-fact on behalf of the Receiver in connection with the management of certain assets. Therefore, it would be improper for the FADA to purchase those properties as you have suggested in your letter. Similarily, it would be illogical for the Receiver to purchase certain of the properties since it currently has loans against them which are in default. While we would be willing to propose that Receiver accept deeds in lieu of foreclosure, we would not do so on the basis which you have suggested. Rather, if a deed in lieu is to be recommended it would only be if we first agreed upon the amount of the deficiency judgment which would be taken with respect to the loans which are guaranteed by W&T.
- 2. Plano Center. Your proposal with respect to the Plano Center loans is unacceptable to us. You say in your letter "No action required. This is a performing loan and on an income property." You are correct that this is a performing loan on an income property (actually two separate loans), however, we believe that this asset should also be a part of any workout proposal. In our opinion you should be willing to pledge to the

Mr. Lionel J. Nowotny February 27, 1987 Page 3

Receiver the ownership interest which W&T or its affiliates may have in this project as additional collateral in connection with the overall workout plan.

- 3. <u>Kelly Boulevard</u>. This loan was guaranteed by W&T. Therefore, we would recommend a deed in lieu only in connection with a previously agreed upon deficiency amount.
- 4. Windscape/Windridge. The FSLIC's acceptance of a deed in lieu of foreclosure on this property seems unlikely because it appears as though the property will be foreclosed upon by underlying lienholders prior to completing any workout Further, in response to statements in your letter the FADA has no obligations to you with respect to these loans. Further, it is our opinion that the Receiver had no obligation to fund the underlying loan payments for several reasons including, without limitation, the fact that W&T is in default with respect to its obligations under these loans.
- 5. <u>Appraisals</u>. We agree with you that the properties should be reappraised. With respect to the appraisal firms to be used, the FADA will choose reputable independent appraisal firms.
- 6. Management responsibilities. As you know, the FADA has been assigned the management of your loans by the Receiver. In our opinion, after the properties securing the loans have been transferred to the Receiver, it would be appropriate for the FADA, rather than W&T, to act as manager of the properties for various reasons, including, without limitation, the nature of the assets, prior management history, and conflicts of interest which may arise given the relationship between W&T and the Receiver. The FADA would, of course be willing to consider any proposals and/or special concerns you may have with respect to any of the properties in connection with such management.

Apart from that, we nonetheless have problems with certain of your management proposals and do not believe they reflect an independent arms-length relationship.

7. <u>Disposition of proceeds</u>. Your proposal for applying the sales proceeds from the properties is, in our opinion, inequitable. As we understand it, what you have suggested combines a limit upon the interest which the Receiver can receive from its investment in the loans and/or foreclosed real estate (see discussion below), no profit participation potential

Er. Lionel J. Nowotny Shruary 27, 1987

- n the event the properties are sold at a profit, and no ignificant guarantee of losses if the properties are sold at a oss (see discussion below). As you can obviously understand, his is an untenable proposal.
- 8. Tarveted Deficiency Concept. This proposal is, in our pinion, completely one-sided and inequitable to the Receiver of Several reasons. First, you propose that we accrue interest ly on the "Target Amount" as specified in your letter. As we iderstand it, the Target Amount is the difference between the irrent indebtedness secured by all properties and the appraised flue of all properties. The effect of this is that prior to its sale, the Receiver is unable to earn a return upon the count of ite investment equal to the value of any real estate ich has been deeded to it. Second, you severely limit the terest which can be accrued even on the target deficiency ration. As you know under the loan documents the Receiver uld charge interest at rates in excess of its ost-of-funds." Third, your deficiency proposal says that if a ficiency exists at the end of seven years, it would only be aranteed on a "cash flow" basis by WFT. This is unacceptable cause you are asking us to release WFT from an absolute and conditional guarantee and replace it with the nonabsolute nditional "cash flow" guarantee. Certainly we would not be tring prudently by recommending such a proposal to the ceiver. Finally, you proposa that the cash flow deficiency it only be for one-half of the target deficiency. In our bruary 23rd meeting you explained that the reason for this was at FirstSouth was to have received a 50t profits interest. at explanation is, however, inconsistent with your proposed stribution of proceeds wherein you have said that "After such me as the Target Amount has been fully paid, WTR will have no rether loss liability and will thereafter be entitled to ceive all net proceeds in excess of the sum of the prorated itial Debt Basis and accrued interest."
- 9. <u>Development Funding</u>. As a general rule we do not lieve the Receiver would be well advised to agree in advance development funding and/or subordination to other development nding in connection with the projects. We would, however, commend that the Receiver look at each project on an dividual basis to determine the viability of further advances or development purposes.
- 10. <u>Business Plan</u>. Appendix I to your letter does not rovide satisfactory business plans because it does not present ecific management and disposition proposals.

Mr. Lionel J. Nowotny February 27, 1987 Page 5

B. ALTERNATIVE WORKOUT PROPOSAL

As discussed above, the FADA would be willing to work with you to consummate a workout of the loans on a reasonable and prudent basis. We feel that the following forms a basis for further negotiations to achieve a satisfactory overall workout. Again, we must say that any such proposal would need to be ultimately approved by the Receiver In this regard, we would be willing to seek tentative approval from the Receiver early in the negotiations to assure you that such negotiations were working toward an ultimately acceptable resolution.

- 1. Windscape/Windridge. It appears as though the properties securing these loans will be foreclosed upon by the underlying lienholders and, therefore, will not be a part of an overall workout proposal. Please let us know if you feel it would be appropriate to consider an alternative approach.
- 2. Frisco Land. We would be willing to take this property back by a deed in lieu of foreclosure as you suggested. However, we would not be willing to do so without first agreeing upon the liability of W&T for a deficiency.
- 3. Plano Center. As discussed above, we would continue this loan as it currently exists but would request that WaT pledge its interest in the property as additional collateral for the other FirstSouth loans.
- 4. Bent Tree. We would propose two options for this loan. The first is that W&T pay one-half of the past due interest on the loan with the remainder to be added to the principal balance. Thereafter the loan would be modified to provide for a three year term with interest accruing at a rate of 9% per annum and payable monthly at a rate of 5% per annum with unpaid interest added to the principal balance of the loan. Under this alternative we would also request additional collateral in an amount and type reasonably satisfactory to us. The second alternative would be for you to give us a deed in lieu of foreclosure with respect to this property and agree upon a deficiency amount.
- 5. Pecan Square. Wit would pay all past due interest on this loan and thereafter the loan would be modified to provide for a two year term with interest accruing and payable monthly at the prime rate of Republic Bank Dallas, N.A. Partial

. Lionel J. Nowotny bruary 27, 1987 ge 6

leases would be permitted as condominium units are sold, so ng as the Receiver is paid the greater of net sales proceeds
110% of the prorated loan balance with respect to the unit ing sold.

- 6. <u>Duncan Perry Road</u>. Again, the FADA would propose two tions. The first would be for W&T to pay all past due terest on this loan and restructure it for an 18 month term th interest accruing at a rate of 9% per annum, but payable withly at a rate of 5% per annum with unpaid interest added to principal balance of the loan. The second alternative would for W&T to give the Receiver a deed in lieu of foreclosure the no deficiency judgment (subject to Receiver's receipt of tisfactory appraisals).
- 7. Quail Valley. We would ask that W&T pay all past due terest, continue making monthly payments of interest, and pay is loan off within 120 days.
- 8. Kelly Boulevard. We would propose a deed in lieu of reclosure with an agreed upon deficiency amount. With respect the sales proposal you have presented us, we would propose at it be approved so long as the Receiver is paid a tisfactory release price with respect thereto.
- 9. The E-Systems Property. We have not yet been able to tain sufficient information on this asset but would need to clude it in our workout proposal.

addition to the specific proposals set forth above, there are me general issues which need to be resolved and which affect weral of the loans As you know, taxes remain unpaid on weral of the properties. In this regard we would expect W&T reimburse the FADA for any taxes it has paid and to pay all ture tax and insurance amounts with respect to the properties curing the loans With respect to the agreed upon deficiency ounts mentioned above, we would expect not only that these be all recourse to W&T, but also that A. Starke Taylor, III and lorge S. Watson personally guarantee these deficiency amounts. nally, the FADA will not be prepared to proceed with any rekout proposal or make any recommendations to the Receiver til such time as we have received full financial disclosure om W&T and Messrs. Watson & Taylor As you know we have ked for current signed financial statements on several casions, but as of yet have not received any such subject to our review of such updated financial information.

Mr. Lionel J. Nowotny February 27, 1987 Page 7

After you have had an opportunity to review the matters set forth in this letter please call me and we can discuss how to proceed further with workout negotiations.

Very truly yours,

FEDERAL ASSET DISPOSITION ASSOCIATION, as Agent and Attorney-in-Fact for the Federal Savings and Loan Insurance Corporation Solely in its Capacity as Receiver of FirstSouth, F.A.

By: John C. Scott

LOL: pb

cc: Donna Harrigan
David Williams
Jim Pendley
Lorne O. Liechty, Esq.
James P. Cooke, Esq.

e:\pb\0227A-30

Federal Asset Disposition Association

5080 Spectrum Drive Suite 1100 E Dallas, Texas 75248 (214) 960-8766

February 27, 1987

Mr. Lionel Nowotny The Watson & Taylor Companies 4015 Belt Line Road Dallas, Texas 75244-2398

RE: Response to Mr. Nowotny's Letter of February 24, 1987

Dear Lionel:

As Asset Manager for your loan portfolio, I am responding on behalf of David Williams to your letter of February 24, 1987.

Upon the closure of FirstSouth, F.A., of Pine Bluff, Arkansas on December 4, 1986, members of the Federal Home Loan Bank (FHLB), the Federal Savings and Loan Insurance Corporation (FSLIC), The Federal Asset Disposition Association (FADA), counsel for all parties, and the accounting firm of Laventhol and Horwath began the task of sorting through the tremendous number of documents that existed at FirstSouth and its branch locations. This was an extremsly laborious and time consuming effort.

Upon our return to Dallas on December 14, 1986, a meeting was arranged between representatives of Watson & Taylor and the FADA for December 16, 1986. The purpose of this meeting was to review your portfolio and discuss possible alternative methods of handling the Watson & Taylor Realty Company (WTR) loans. I stress the fact that December 16, 1986 was the first day of any meetings between FADA staff and any of the FirstSouth borrowers, indicating the high priority we have placed upon resolving the problems with WTR..

At that first meeting, WTR was told that the tentative proposal as negotiated between WTR and a representative of the J.E. Robert Company was not acceptable as a basis that would be recommended by FADA and to FSLIC as Receiver. Further, the FHLB did not approve the proposal as submitted.

We do acknowledge your cooperation in the supplying of loan and property information. We promptly reviewed all information which you provided us and made personal site inspections on each property during the month of Dacember.

Mr. Lionel Nowotny February 27, 1987 Page Two

It should also be noted that at our December 16, 1986 meeting, Mr. Bob Patterson of Hopkins & Sutter specifically requested information from Messrs. Watson and Taylor concerning the borrower's financial condition and loan exposure with other savings and loan institutions. On December 30, 1986, David Williams forwarded a letter again requesting this information (copy enclosed). I, on two separate occasions, reiterated the necessity for this information. To date, WTR has chosen not to respond to these requests.

During the month of January, we diligently researched and responded to problems within the loans as they relate to underlying lien holders and value analysis. As you may recall, I requested a meeting with Mike Berry and you to discuss any and all problems of this nature as they relate to all the assets in the WTR portfolio. This meeting was held at FADA's offices on February 4, 1987.

Also, during the month of January numerous phone conversations took place for purposes of fact finding. These discussions were principally with development partners of WTR. At our February 6, 1987 meeting, it was once again reiterated that the proposal set forth in December was not satisfactory, and we went to great length to provide information that we felt would be substantive and crucial to any proposed workout. We also stated that the Receiver's decision not to fund the payments due on the Windscape/Windridge underlying loans was likely irrevocable. At that February 6 meeting you stated that neither Hessrs. Watson and Taylor nor WTR intended to make any financial commitments to work out these loan problems. This is an extremely unusual and uncooperative position for a borrower to assume.

During the entire period since the first meeting of FADA staff and WTR, we have been open to input on projects under your control. Further, we have, in fact recommended payments be made on behalf of WTR. Specifically, payments are to be made by the Receiver to the underlying lien holders on Duncan Perry and payment for taxes and assessments on numerous properties have been made as requested.

Lionel Nowotny bruary 27, 1987 ge Three

R's input as to the Windscape/Windridge appraisal was not mied. During the month of January with the appraisal efforts! Cushman & Wakefield (CW), no less than three phone calls took ace between CW and Mike Berry of WTR for purposes of iformation gathering. A meeting was held February 11, 1987 at the offices of WTR to discuss the appraisal process as conducted? CW. Diane Bowman of CW and Britt Lemmons of FADA were resent at that meeting. As a result of that meeting, CW agreed increase its appraised value based upon information you rowided.

the thing needs to be reclarified at this time. The FADA makes by ultimate decisions as to payments of funds. We do, however, the recommendations to the Receiver who, in fact, makes the ltimate decisions for payments.

conclusion, we find great difficulty in accepting the broadings of accusations and insinuations made in your letter. We testion your position due to the fact your arguments which are large order directed to loans that are either in default or we matured. We are surprised that WTR and Messrs Watson and lylor have refused any requests to make any financial manitaments to the projects securing these loans, but rather the chosen to blame all their problems on the slow economy and lyerse lender relations.

.ease feel free to comment as you see fit.

Mn C. Scott

ncerely,

:S/edk

:: David Williams
Bill Swift
Jim Pendley
Donna Harrigan
Robert Patterson
Lorne Liechty

\0227-1js

Federal Asset Disposition Association 5080 Spectrum Drive Suite 1 100 E Dailas, Texas 75248 (214) 960-8766

December 30, 1986

Mr. Starke Taylor, III Mr. George Watson The Watson & Taylor Companies 4015 Beltline Road Dallas, Texas 75244

Dear Tracy & George:

As a follow up to our December 16th meeting, where you and your counsel were advised of FADA's management responsibilities to the FSLIC Receivership of First South Savings and Loan respective to your company's loan portfolio, I herein reiterate our verbal request for loan information on all properties owned and/or controlled by you individually, by Watson & Taylor Realty and all affiliated entities. We specifically need a schedule which delineates for each individual asset the following:

- 1. A brief property description, asset name and location.
- Any and all lien holders, their respective lien position showing total loan commitment and current outstanding balance and final maturity date.
- 3. Additional pledged collateral.
- Current appraisal information stating the appraisal firm, appraisal date and value.
- Borrowing company name along with percentage owned and/or controlled by you or the Watson & Taylor entities.

The schedule must reflect every loan of Watson & Taylor Realty and all affiliated entities, not just those loans to First South Savings of Arkansas.

We also respectfully request that you provide us with current certified operating statements for the past twelve months on each individual property.

The Watson & Taylor Companies December 30, 1986 Page Two

In addition to the aforementioned schedule and statements, we must be provided current financial statements on yourselves individually, as well as Watson & Taylor Realty, and all affiliated companies. The financial statements should be fully documented, dated and signed and must be current within sixty (60) days.

FADA is presently analyzing the information provided by your staff; however, we are not prepared to make any business decision respective to your loan portfolio until all documents have been reviewed and the above requested information has been provided to us.

We truly appreciate your cooperative spirit and look forward to a prompt amenable resolution.

Sincerely,

David R. Williams Vice President

DRW/edk

Carlo STALLO

February 24, 1987

Mr. David Williams Federal Asset Disposition Association (FADA) 5080 Spectrum Drive, Suite 1100E Dallas, TX 75248

RE: Watson&Taylor/FirstSouth Loan Portfolio

Dear David:

On December 4, 1986 FirstSouth Savings of Little Rock, Arkansas, was placed into receivership by the Federal Home Loan Bank Board (FHLBB). Prior to that event, Watson&Taylor Realty Company (WTR) had been negotiating its loan portfolio with FirstSouth while it was under FHLBB supervision for over 41 months. Negotiations were conducted with consultants hired by FirstSouth under FHLBB irection. These negotiations resulted in a letter agreement on disposition of the WTR/FirstSouth portfolio which was to be signed during the same week in which FirstSouth was placed into receivership.

On December 15, 1986, eleven days following FirstSouth's takeover by the FHLBB Watson&Taylor Realty Co., with assistance from Congressman Bartlet was allowed to meet with you in the offices of the Federal Asse Disposition Association (FADA). During that meeting Messrs Watson Taylor and I stated that a tentative agreement existed which had been carefully structured by approved consultants to FirstSouth with FHLBB knowledge. This agreement could have been immediately implemented. We also emphasized the substantial negative impact of delay on WTR's ability to conduct to business. The significant size of the total WTR land portfolio and the potential for serious financial repurcussions throughout the financial community was tressed as another compelling motivation for timely action. As you indicated that you did not have records WTR volunteered to supply FADA with copies of all loan documents on the FirstSouth portfolio, and to hold detailed briefings for your staff on each individual project to expedite the negotiations. Complete files were delivered to you on December 18, 1986, three days following our initial meeting. In a letter dated December 19, 1986 I reitersted our concerns and anticipated a first joint working session on December 22 which had been agreed upon at the previous meeting.

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FADA FEB 25 1987

DALLAS

The Watson&Taylor Companies: 214/386-9070
Corporate Address: 4015 8ch Line Road | Dallas, Texas 75244-2398 Mailing Address: P.O. Box 819092 | Dallas, Texas 75381-9092

WATSONESTAYLOR

Mr. David Williams February 24, 1987 Page Three

In your dealings with WTR to date, you have displayed a lack of legitimate effort to understand or pursue resolution of the matters in question. You have failed to respond to any issues of urgency. You have consciously impacted the ability of WTR to conduct its ongoing business, thereby damaging its reputation and its relations with other creditors. FADA's actions and lack of responsiveness seem to indicate a lack of good faith; although, it is sincerely hoped that this is not the case.

WatsoneTaylor Realty Co. has continued to apply substantial resources to the orderly disposition of these properties; however, your cooperation is required to conclude a disposition agreement on an immediate basis.

Very truly yours,

WATSON&TAYLOR REALTY COMPANY

Lique H. Howolny

President

LJN:mo



FEB 20 1987 DALLAS

February 18, 1987

Mr. David Williams
Federal Asset Disposition Association (FADA)
5080 Spectrum Drive, Suite 1100E
Dallas, TX 75248

RE: FIRSTSOUTH Savings/Watson&Taylor Realty Co. Loan Portfolio Disposition

Dear Mr. Williams:

During our meeting of February 6, 1987 we discussed the Watson&Taylor Realty Company (WTR) real estate loan portfolio originally held by FIRSTSOUTH that is now being administered by FADA. The following proposed set of actions is offered as the basis for an Agreement on this matter. The elements are:

- WTR will sell all assets listed on Exhibit "A" on which FIRSTSOUTH has outstanding loans to FADA. The selling price will be equal to the outstanding loan amount (individually "Debt Basis," collectively "Total Debt Basis" defined as the cash actually advanced by FIRSTSOUTH plus the amount of superior lien debt.
- Other assets, not listed in Exhibit "A", will be dealt with as follows:
 - Plano Center No action required. This is a performing loan on an income property.
 - * Kelly Boulevard Deed to FADA in lieu of foreclosure. As the loan on this property is non-recourse, there is no further obligation and no potential deficiency to WTR.
 - Windscape/Windridge Deed to FADA in lieu of foreclosure with no further obligation and no deficiency claim against WTR This action is based upon the assumption that FADA upholds its decision to not honor its obligation to make the required payments to superior lienholders. If such payments are made then this property will be treated in the same manner as all other assets listed in Exhibit "A".

EXHIBIT B

The Watson & Taylor Companies: 214/386-9070

Corporate Address: 4015 Bek Line Road | Dallas, Texas 75244-2398 Mailing Address: P.O. Box 819092 | Dallas, Texas 75381-9092

WATSONSTAYLOR

Mr. David Williams February 18, 1987 Page Two

- Frisco Same as above for Windscape/Windridge, except that it relates to FADA decisions regarding obligations to the senior participants in the Frisco loan rather than to superior lienholders.
- 3. Current appraisals will be obtained on each property to establish an initial value for the assets (individually "Initial Appraisal Basis," collectively "Total Initial Appraisal Basis") Appraisal cost will be shared on a 50/50 basis between WTR and FADA. The Appraisal firms selected will be mutually agreed to by WTR and FADA.
- 4. An exclusive "Agency/Management Agreement" will be entered into between WTR and FADA. The principal elements of this Agreement are as follows:
 - a. WTR will manage, develop and sell the subject assets on behalf of FADA for a period of seven years from the date of title transfer.
 - b. All proceeds, net of closing costs, from sales will be distributed in the following order:
 - To the prorated initial Appraisal Basis of the parcel sold.
 - (2) To the prorated basis on any development funding provided by FADA in accordance with subparagraph 4.h. below.
 - (3) To prorated accrued interest at a rate equal to the "Published Cost-of-Funds" on the current balance of the Target Amount. The "Target Amount" is defined as the Total Initial Debt Basis minus the Total Initial Appraisal Basis. (The Target Amount represents the basis for determining a cap (maximum) on the liability of WTR for potential future losses.)
 - (4) To the Target Amount.
 - (5) Prior to the time that the "Target Amount" is fully paid, WTR will receive monthly credit for preapproved overhead associated with its committed management services and accumulated accounts receivable.

TYATSONCJINYLOR

Mr. David Williams February 18, 1987 Page Three

After such time as the Target Amount has been fully paid, WTR will have no further loss liability and will thereafter be entitled to receive all net proceeds in excess of the sum of prorated Initial Debt Basis and accrued interest. Such consideration will be granted for applicable sales made during the term of the Hanagement Agreement and any mutually agreed extensions thereto.

- c. A time period of seven years will be established for each asset during which time the Management Agreement will be in effect.
- d. Under the Management Agreement, WTR will have the right to recommend sales prices ("Recommended Sales Price"). Should FADA desire to sell any parcel for a price less than the Initial Appraisal Basis on that parcel ("FADA Desired Sales Price"), then the Target Amount will be decreased by an amount equal to the prorated portion of the "Target Amount" attributable to the subject parcel. This is in recognition of the fact that such a sale, dictated by FADA, denies WTR the opportunity to reduce the "Target Amount" during the period of the Management Agreement.
- e. Under the Management Agreement, FADA will agree to make purchase money loans to buyers at prevailing market rates and terms.
- f. WTR will quantify the management services to be provided on the subject assets as a part of the Management Agreement.
- g. WTR will submit quarterly written reports to FADA documenting its efforts in managing and selling assets.
- h. FADA will fund necessary development to enhance saleability when recommended by WTR. Should FADA approve the recommended development, but elect not to fund the cost of development and WTR is successful in securing the financing from third party sources, then FADA will grant a priority lien to the construction lender on the affected tract.
- FADA will reimburse WTR for preapproved third party out-of-pocket costs incurred by WTR in carrying out its management responsibilities.

WATSONGTAYLOR

Mr. David Williams February 18, 1987 Page Four

- 6. At the end of the established Management Agreement period, if assets still remain and the Target Amount has not been fully accumulated, then the following procedure will be followed unless the Management Agreement is extended by mutual consent:
 - a. A final set of appraisals will be obtained on remaining assets ("Final Appraisals"). The cost of these appraisals will be shared 50/50 by WTR and FADA. The Appraisal firm selected will be one mutually agreed to by WTR and FADA.
 - b. If the Total Final Appraisals, in the aggregate, exceed the Final Outstanding Total Debt Basis, defined as the Initial Total Debt Basis less paydowns plus any unpaid accrued interest on the Target Amount, then WTR has no further monetary obligation for potential future losses or otherwise.
 - c. If the Total Final Appraisals, in the aggregate, are less than the Final Outstanding Total Debt Basis then WTR will agree to issue a "cash flow" type note for an amount not to exceed one-half of the lesser of the unaccumulated portion of the Target Amount or the Final Outstanding Total Debt Basis minus the Total Final Appraisals.
 - d. In the event that a "cash flow" note is required under the provision of paragraph 6.c. above, then WTR will apply one fourth of its net after tax cash earnings to the reduction of this note until it is fully retired.
- 7. Appendix I contains business plans for each property affected by this Agreement. It should be noted that each of these plans assumes an accrued interest rate applied to the entire debt as there is no current rationale for assuming a specific "Target Amount" at this time. Thus, the assumption used is conservative relative to the ability to repay the total aggregate debt.

If you agree that the above discussion represents the terms upon which formal legal documentation may be prepared, please indicate your concurrence as provided for below. Watson&Taylor Realty Company considers

NOTE SONG TAYLOR

fr. David Williams Pebruary 18, 1987 Page Five

these	terms	to be	fair	and	equitable	to	both	perties	and sta	ands
ready	to com	plete	this	tra	nsaction a	t th	ear	liest p	ossible	time.

Sincerely yours,

JATSON&TAYLOR	REALTY	COMPANY
ionel.	Nou	voly

resident

JN:mo

inclosures

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ly .																
	FEDE	RAI	. ASS	SET	DISP	0S1	TION	ASS	SOCI	ATI	ON					

EXHIBIT "A"

Assets to be Sold to FADA

- Pecan Square
- Duncan Perry
- Bent Tree Center
- Quail Valley

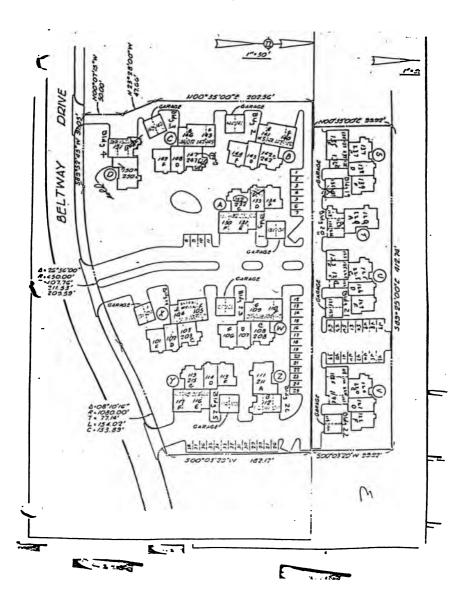
BELTWAY BOULEVARD/PECAN SQUARE

Beltway Boulevard/Pecan Square - Business Plan

Attached you will find the budgets and rent rolls for these two income producing properties.

Page 1

							BOULEVAR			OGET			n:	GLENN SC	uate i	V15/8:
							AN SOUN		-							
REVENUE		FED	MAR	APR	MAY	JUE	JULY	AUG	SEPT	OCT	MOV	DEC	TOTAL		DEC/SF	SOFT
#109	750	750	750	750	750	750	750	725	725	725	725	725	8.875	9.28	0.48	107:
111	465	445	665	645	445	665	665	475	675	675	675	675	8.030	8.34	0.70	761
113 117	450	450	450 493	450 425	450 425	650 625	640 625	640 425	640 625	660 625	660 625	660 625	7.860		0.69	952
		0				425	425	623 625	425	625 625	425		6.118	4.18	0.43	996
118	685	•	. 0	625	625	145	945	745	745	745	745	625	6.310	5.89	0.58	1072
119 123	745	745	745	745	745 645	445	45	145	143	440	440	745	8.940	8.34	0.67	1072
	645	645	645	445				750	750			660	7.800	7.88	0.67	990
124 127	750	750	750	750	754	750 685	750 6 8 5	485	/30 485	750 485	756 485	750 685	7.000	8.40	0.70	1072
131	685 725	685 725	485 0	485 485	485 485	485	485	485	485	485.		685 685	8.220 7.415	8.55 7.10	0.71	961
131	123 695	495	695	425	425	625	625	625	425	425	625	625	7,710	7.79	0.44	1072 990
136	673 0	673 0	673 725	923 725	725	725	725	· 725	725	725	725	923 725	7.250	4.74	0.68	1072
139	660	475	175	125	625	625	625	425	425	625	425	625	7.435	8.02	2.44	952
141	750	750	750	750	750	750	750	750	750	750	75C	750	7.000	8.40	0.70	1072
145	450	450	450	450	450	450	450	440	440	660	660	660	7.850	7.93	0.47	990
146	730	730	730	730	730	730	730	730	730		¢ 730	730	8.760	8.17	0.68	1072
211	685	485	485	485	685	625	625	625	625	425	625	625	7,800	8.12	0.45	961
227	475	675	475	675	675	675	475	485	485	485	685	685	8.150	8.48	0.71	961
LESS: W DEPOSITS	ACANCY	OF 892					2.240 1	2.245	2.260 1	2.260	12.250	12.260	142.923 15.722 500	7.82	0.67	18.294
EFFECTIV	JE REVE	NUE											126.701	6.93		18.284
DIPEISES	s:										PER	HTMOK				
					s and f	EST CON	ITROL FE	Ε					23.789			
			ELECTRI									83	1.000			
			INSURAN					•				42				
			LEGAL/A									167				
			MAKAGEN									634	7.602			
			REAL ES									1.733	20,800			
							FFICE C		esse/n	U)		394	720			
							12 UNIT	5 4500				60 40	720 480			
			SHAMPOO				HATED H					400	4.800			
							IONS PIL		,			38	456			
			OFFICE			i/ en i and	Wu2 611	307				30	360			
			PAYROLL		-	0 00010	,					1,573	18.870			
			TELEPHO		20C1U15	ט נטטוט)					45	540			
			TRAVEL	~~								15	180			
TOTAL	EXPENS	ES	692	OF REVE	NUE							7.235	86-816	4.75		
NET OPER	ATING :	INCOME	(DEFICI	T)							•	3.324	37.895	2.18		
CAPITAL	ADDITE					IRS. WAS	HERS. 1	DRYERS	;			138	1.650			
			RPET TO		LACEB							395	4.740			
DEBT SER			' 4 9 44A L (FIRS)						1	5.687 0	198-248 0			
NET CASH	FLOW										-1	2.894	-154,753	-8.46		



INCOME STATEMENT

ERTY:		
/// MONTHS_	THRU	CH

COME	CURRENT MONTH	YEAR TO DATI
Interest Income	14 42	2 999.76
Rent Income	2252.00	26263.54
Miscellaneous Income		
Sales		
Cost of Sales		
TAL INCOME	2, 424,42	_23,303.30
PENSES		
Accounting		
Advertising		
Appriasal Fees	914.66	914,640
Amortization mudit Exp.		<u> </u>
Bank Charges	3.38	
Closing Costs Couleact LAboR	1136-00	1500.00
Commission Fees		<u> </u>
Credit Verification Depreciation		25.00
Development Costs juip hearte		29.74
Dues & Subscriptions		24.55
Fees/Licenses		20.93
Homeowner's Dues	54/.72	2417.00
Insurance		K/4.66
Insurance Loss		
Interest Expense		11.202.94
Legal/Professional		250.00
Maintenance	27	=:57.01
Management Fees		
Miscellaneous		<u> </u>
Office Supplies	12.04	<u> </u>
Postage		2.7/
Printing		414 4 34 414
Repairs	37.60	<u> </u>
Salaries	4.7.24	= /20 PP
Security Systems Serviced. Taxes - Payroll	22.45	<u>- 13.09</u>
Taxes Real Estate		-15.41
Telephone		=1.42
Trash Removal		2.00
Travel & Entertainment		: 20
Utility - Electric		.4794
Utility - Gas		
Utility - Water		
TOTAL EXPENSES	3 749.16	47 50.47
		(= 4 9:17:11)
NET INCOME (LOSS)	<274.74>	(a 4 / 4 /.///

7570

	Addison 75244	
	Dr., Add	
	e, 4067 Beltway	
	4067	
•	-	
DEPOSITS	Ventur	
URITY DEPOSITS	Ventur	
OF SECURITY DEPOSITS	Ventur	
RECORD OF SECURITY DEPOSITS	Ventur	
AND RECORD OF SECURITY DEPOSITS	Ventur	
AT ROLL AND RECORD OF SECURITY DEPOSITS	Ventur	

4/1/06

Bep: Refund		196	953	940		1.32	940	10.00	1	196	1072	990	107	200	151	1101	06/	1072	196	18 203
Nove					1					0					T		1	1	Ì	T
DEC.	725	665	650	625	618	133	545	750	1	020	0			1	725	33	1	2 9		306
'AON	725	599	650	625	615	725	549	750	650	685		635	725	525		655.	_	-	_	116
.T00	725	. 999		625	615 615	689	645	750	650 650	685		635	1	525		\$88	1		675 675	.61
.T432	725	599	650	625	615	725	645	750	650	685	1	635		625	725	655	725		675	00
vnc.	725	300	650	625	615	745	645	750	059	683	1	635	725	625	725	655	1	486		5Z 91
חרג	725 7	665	650		615	745 7	9 549	750	650	685	1	635	725	625	1	650	1.	525	675	06
JUNE	548	999	650	625	615	745	9 5 9 9	750 7	685	685	- OK	24 6	725 7	625	1	650	730	287		98
MAY B		9 599	650 6	625 6	615	745 7	9 549	750 7	685 6	685 6	2 569		725 7	625 6	7	650 6	730	685 2	675	05
PIRA		9 599	9 059	625 6	615 6	745 7	645 6	750 7	685 6	685 6	695 6		725 7	9	-	650 6	730 7	685 6	675 6	1
MARCH	750	9 599	650 6	667	_	745.7	9 579	750 7	685 6	9	695 6	+	725 7	675	- 052	650 6	73-7	685 6	675 6	SZ
	750 7	9 599	650 6	4	1	745 7	645 6	7 057	685 6	725			7	675 6	750 7	650 6	730 7	685 6	675 6	89
833	750 73	99 599	650 6	1	685	745 7	645 6	750 7	685 6	725 7	569 569		-	9 099	750 73	650 6	730 7	685 68	675 67	57
DEC.	_	9	9		9	72	9	7.	-	12	10	4	-	9	7	9	12	1 30	6	24
AON	98								86	+	+	+					H	+		
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Janur	the contract of	_m	×					**		1	t	1	1			-		1	1	i
MYA						U.L.					87							18		
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HAL			9	-m-		-0	-	9		12					87					
DEPOSIT	009	450 150 Pe	400 250PD	300	400	400	004	200	450	350	350		450	325	300	400	400	400	400	
RENT	725	599	650	625	615	725	549	750	650	685	625		725	625	Mars 17725	655	725	553	675	
NAME	MAINER, Janet	KAUFHAN, Dorothy	SAKEACH, Lisa -DEGROOT, Heak	TERRELL, Michael	YERXA, Rebecca	HART, Dorfs	WARD, Carol	DARNELL, Marilyn	SEWARD, Phil & Mary	JRIDI, Ahmad	MILHOLLAND, Cynthia		THOMESON Catherine	THOMSON, Laura	SCHELL, David Miller, Mari	BARNHARDI, Joe	GEIGER, Mary Ann	GREARPH LISS MILE	BROOKS, T.A.	**
TIMO	601	111	113	111	118	611	123	124	129	5	135		136	139	141	145	146	211	229	

BALANCE SHEET
AS OF 10.5116

ASSETS

Cash in Bank Accounts Receivable Prepaids Mortgage Receivable Notes Receivable Jobs in Progress	Total Current Assets	// 854.37 @9.522.22 #22.53	35 049.19
Land		229.3:4.6	• • •
Building Less Accum. Depr. of	186 479.00	1056 914 90	
Furniture & Fixtures , Less Accum. Depr. of			
Pri Lescabeld-Transporter	<u> </u>	3.442.29	
Less Accum. Depr. of	19.712.57	1.491.69	
	Total Fixed Assets	,,	1,2/3,628,93
Current Period Interest & To Less Accum. Amort. of	axes		•
Deferred Finance Charges Less Accum. Amort. of	1.416.22	1982.75	
Loan Fees Less Accum. Amort. of			
Organization Costs			
Less Accum. Amort. of Syndication	1/7!	242.33	
Utility Deposits Investment In			
	Total Other Assets		0 0.467
*****			135930200
TOTAL ASSETS			
	LIABILITIES		
Accrued Expenses Payable Accrued Interest Payable Accrued Taxes Payable Accrued Taxes Payable Accts/Payable - Uther Credit Fees Payable Pet Deposits Payable Security Deposits Payable Deferred Gain on Sale Mortgages Payable Notes Payable		(291.1) 1187.24 275.00 \$16.00 6109.00	
•	Total Liabilities		159414423
	OWNER'S EQUITY	•	•
Capital Current Earnings Detained Earnings		2476:621 (12 442.13) (170,024.60)	
	Total Owner's Equity		(234841.14)
TOTAL LIABILITIES & OWNER'S	EQUITY		1359 30304

INCOME STATEMENT

PROPERTY: Betting Blad FOR 10 MONTHS gran THRU (Cot

INCOME	CURRENT MONTH	YEAR TO DATE
Interest Income Rent Income Miscellaneous Income Sales Cost of Sales	114:0.19	102.318.71 £80.00
TOTAL INCOME	11 400,04	107.738.79
EXPENSES		•
Accounting Advertising Appriasal Fees Amortization Bank Charges Closing Costs Commission Fees Credit Verification Depreciation Control Land Development Costs Junes Development Costs Junes Dues & Subscriptions Fees/Licenses Homeowner's Dues Insurance Insurance Loss Interest Expense Legal/Professional Maintenance Management Fees Misce laneous Office Supplies Postage Printing Repairs Salaries Security Systems Java Control Taxes - Payroll Taxes - Payroll Taxes - Real Estate Telephone Trash Removal Travel & Entertainment Utility - Electric Utility - Gas Utility - Water	1.7/2.42 1.7/2.42 1.7/2.42 2.7/2 2.7/2 1.7/2.42 2.7/2 1.7/2.42 1.7/2.42 1.7/2.42 1.7/2.42 1.7/2.42	14.29.21 1.25.20 1.25.20 1.20.00 1.25.21 1.564.07 1.564.07 1.7.22 257.00 13.72 41.50 15.75 17.41.20 15.75 17.41.20 15.75 17.41.20 15.75 17.41.20 15.75 17.41.20 15.75 17.41.20 17.21.20
TOTAL EXPENSES	1.071.1.5	130 111.62
NET INCOME (LOSS)	5.271.81	12.11: 31

STATEMENT OF CHANGES IN FINANCIAL POSITION - CASH BASIS

NAME: Belture Blu

DATE: 64 SOURCES OF CASH <12.44a.83). 5.371.84 -Net Income + Depreciation + Amortization Capital Contributions Increases in Liabilities 94.500.00 AIP - WTR 1.167.34 AIP - Security Departe Double Decreases in Assets 127455.36 3371.14 TOTAL SOURCES OF CASH USES OF CASH Decreases in Liabilities
Alphant Mysit Papile
(Leann) January Burgle 22019.04 Increases in Assets 1491.64 124.862.42 22019.04 TOTAL USES OF CASH NET INCREASE (DECREASE) IN CASH 67.647.20 9.261.62 Prior Month Cash Balance 39.501.37 11.2511.27 TOTAL CASH

		0 .		• .
		lean &	quare "	
			Patie and/or	26
Unit #	Square Feet	\$ of Total	Balcony Sq Ft	
A130 F	990	PHASE I - 1.7508	96	•
A131 E	1,072 68 3	1.8959 1,2079	96 172 45	
Z SEIA	1.029	1.8198 1.6836	158 78	•
A232 C	952 68)	1.2079	45	
. 8141 E	990 1,072 68 3	. 1.7508 1.8959	96 172	/ / .
8142 G	1.829	1.2079 1.8198	45 158 78	/
8144 F 0242 C	952 68 3	1. 6836 1.2079	78 45	
C145 F C146 E	990	1.7508 1.8959	96 172	
C147 C C148 D .	1,072 683 1,029	1.2079 1.8198	172 45 158	
C149 F	952 683	1.6836 1.2079	78 45	
0150 A	961	1.6997	90	
01513 0250 A	699 961	1.2362 1.6997	72 90	
V106 F	952 1,029	. 1.6836 1.8198	78 158	
¥107 € ¥108 € ¥109 €	683 1,072	1.2079 1.8959	158 45 172	
V110 F V208 C	990 6 8 3	1.7508 1.2079	96 45	
¥161 \$	952	1.6836	78	•
X102 =	1,029 . 683	1.8198 1.2079	158 45	
- · X104 =	1,072 990	1.8959 1.7508	172 96 45	
X203 C	683 952	1.2079 1.6836	78	•
Y113 F Y114 D Y115 G	1,029 683	1.8198 1.2079	158 45	
Y115 G Y116 S Y117 F	1,072 99 0	1.8959 1.7503	172 96 •	
7215	. 683 961	1.2079	45 .	•
21114 2112B 22114	699 961	1.6997 1.2362 1.6997	90 72 90	
22117	70 1	PHASE II	,,,	
. \$135 F	. 990	1.7508	96	
\$136 E \$137 C \$138 D	1,072 683	1.8959 1.2079	172 45	
\$139 P	1,029 552	1.8198 1.6836	158 78	
T128 3	683 699	1.2079 1.2363	4 5 72	
T129 4 T229 4	961 961	1.6997 1.6997	90 90	
U123 F	990	1.7508	96	
11128 C-	1,072 683	1.8959 1.2079	172 45	
0126 D 0127 F	1,029 952	1.8198 1.6336	158 78	
U225 C V118 F	683 990	1.2079 1.7503	45 96	
V119 F	1,072 683	1.8959 1.2079	172 45	
V120 G V121 D V122 F	1,029 952	1.51e? 1.6 5 76	153 -2 +5	
V220 C	683_	1.2679 105.6563		
Thu phac A. saises	56,544		6,102	
B. Errelev				
> :		•		

Paide Square 3.0 BALANCE SHEET AS OF 10-21-26

ASSETS

Cash in Bank Accounts Receivable Prepaids Mortgage Receivable Motes Receivable Jobs in Progress	Total Current Assets	21 2 94.03 25 24.1.64	<u> 44.535.49</u>
Land Building Less Accum. Depr. of Furniture & Fixtures Less Accum. Depr. of Lessehold Improvements Less Accum. Depr. of		8.65204	246,418.26
Current Period Interest & Ta Less Accum. Amort. of Deferred Finance Charges Less Accum. Amort. of Loan Fees Less Accum. Amort. of Organization Costs Less Accum. Amort. of Syndication Utility Deposits Investment In	xes 153 172.00 1 259.20 2 49/4	15, 140.27 ~ 24.25 ~ 25.76 ~ 47.22	
TOTAL ASSETS	Total Other Assets		<u> </u>
Accrued Expenses Payable Accrued Interest Payable Accrued Taxes Payable P/P W1 Accts/Payable - WTR Accts/Payable - Other Credit Fees Payable Pet Deposits Payable Security Deposits Payable Deferred Gain on Sale Mortgages Payable Notes Payable	ਾ <i>ਸੀ</i> Total Liabilities	12.712.42 21.40.08 22.31) 2.52.00 2.52.00 2.52.00	<u> </u>
Capital Current Earnings Detained Earnings	OWNER'S EQUITY	119 244 97 (04 947,17) (02 72752)	

STATEMENT OF CHANGES IN FINANCIAL POSITION - CASH BASIS

NAME: Pern Swar IV,		
DATE: Dof 1916	·	
SOURCES OF CASH		*
Net Income	·· <u>\? 74.74</u> }	_{24 847.17}
+ Depreciation + Amortization	•	
Capital Contributions		<u> </u>
Increases in Liabilities		
AP-Buttony Blod AP-Comer Great Security Report tought AP-WTM	1/41.9/	71.53 245.12 700.00 4 347.24
Decreases in Assets		
Preprid laserone		
TOTAL SOURCES OF CASH	774.17	(9,036.30)
USES OF CASH	•	
Decreases in Liabilities AP-WTR AIP-Worm Course. Georgia Internationals	÷ 202 00	28.802.53 22.300.00 // 338.93
Increases in Assets	•	•
Levelal Ingrammate		<u> </u>
TOTAL USES OF CASH	_ = :00.00	70.514.00
NET INCREASE (DECREASE) IN CASH	4225.83	78 603.10
Prior Month Cash Balance	2551924	44997.13
TOTAL CASH	21.294.03	212:4.13
•		P.S.7

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PECAN SQUARE JOINT VENTURE 1986 BUDGET

RENT REVENUE			ANNUAL	HONTHLY
		560X12	6,720	560
				469
				615
				527
			26,050	2,171
expenses			7 500	000
	HOME OWNER	RS DUES		292
	Insurance			200
		INISTATION		10
	REPAIRS 1	HAINTENANCE		350
	SALARIES			238
		YROLL		52
	TAXES - RE	IAL ESTATE	4,620	385
	TELEPHONE			10
	UTILITIES	- ELECTRIC	120	10
			19,157	1,596
NET OPERATING	INCOHE		6,893	574
EXTRACRDINARY	ITEN: CASI	REG'D FOR HVAC'S	9,275	773
INTEREST EXPEN	SE: (11,340	OTRLY TO FIRST SOUTH)	45,360	3,780
NET CASH FLOW			-47,742	-3,779

PREPARED BY: GLENN SCHULTZ WTH 6/3/66

DUNCAN PERRY

MEMORANDUM

Date: February 20, 1987

To: Mr. John Scott (FADA)

From: R. Michael Berry

RE: Duncan Perry

Enclosed for your review is a business plan for our Duncan Perry property in Grand Prairie, Texas. This plan, which was forwarded to Henry Lorber in October 1986 and to you in December 1986, still reflects our current thinking on the project. The pro-forma reflects an interest accrual on the FIRSTSOUTH indebtedness at cost of funds and indicates that substantially all of the current investment is recoverable through a program of development for orderly disposition.

I have also included two pro-formas which reflect immediate liquidations (i.e. - bulk and a user parcel). I believe these pro-formas adequately demonstrate that the project economics are enhanced by disposing of the project in an orderly fashion as the market recovers.

NOTYKIYMOETYW

October 14, 1986

Mr. Henry P. Lorber President Realty Asset Management, Inc. 100 Colony Square Suite 200 1175 Peachtree Street Atlanta, Georgia 30361

RE: Duncan Perry

Dear Henry:

Enclosed for your review are revised financial projections for our Duncan Perry property. The projections have been revised to reflect a lower financing rate for FirstSouth borrowings equal to that institution's cost of funds. Additionally the projections have also been revised to provide for a distinction between a loss of cash currently invested by FirstSouth and a loss associated with interest accrued by FirstSouth.

Please do not hesitate to call me if you have any questions or comments.

Best wishes,

TA WATSON&TAYLOR COMPANIES

R. Michael Berry

RMB/nb

Enclosures - As stated

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The Watson&Taylor Companies: 214/386-9070
Corporate Address: 4015 Bek Line Ruad | Dallas, Texas 75244-2398 Mailling Address: P.O. R., Genorate O.H., T.

DP-172

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FirstSouth, F.A total 2,439,629	i	2,386,955	2,407,956	1,636,886	1,655,885	1,63,78	1,6%,444	1,717,288	1,730,654	1,748,494	1,743,639	1,85,39	1,09,43	1,682,477
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WINDSCAPE/WINDRIDGE

MEMORANDUM

Date: February 20, 1987

To: Mr. John Scott (FADA)

From: R. Michael Berry

RE: Windscape/Windridge

Attached hereto are pro-formas for the above-captioned property. These pro-formas reflect the following:

Accrual of FIRSTSOUTH interest at prevailing cost of funds;

• The following three approaches to the project have been analyzed:

(i) immediate bulk liquidation;

(ii) bulk sale after market recovery; and

(iii) sale of developed parcels.

A review of these approaches indicates that the current FIRSTSOUTH investment is recoverable only through a program of realizing the value of the zoning by developing the property for sale in an orderly fashion. This program is consistent with our original intentions and agreements with FIRSTSOUTH.

Finally it should be noted that there is liquidation value substantially in excess of that reflected in the current and ongoing Cushman & Wakefield appraisal. This "current value" can be demonstrated by careful scruting of current comparable information.

MULTANCE IN

October 14, 1986

Mr. Henry P. Lorber President Realty Asset Management, Inc. 100 Colony Square Suite 200 1175 Peachtree Street Atlanta, Georgia 30361

RE: Windscape and Windridge Apartments

Dear Henry:

Enclosed for your review is pro-forma information for the above-captioned project. Pro-forma information is presented for three different scenarios as follows:

...

- (i) An immediate liquidation of the bulk undeveloped tract;
- (ii) A bulk sale of the undeveloped tract after the market has "bottomedout" and values have "firmed-up"; and,
- (iii) The development of the bulk tract and sale of the component parcels. (Note: An analysis of estimated site development costs is also included as an attachment to this letter).

As a general observation, I believe that a scenario in which we hold the property through the current downturn will minimize the exposure to a loss of cash currently invested in the deal. (Note: The projections make a distinction between losses of cash and losses associated with accrued interest).

On a separate note, and as we have previously discussed, I am in the process of changing management companies for our apartments on the Windscape and Windridge tracts. This change, which will become effective on December 31, 1986, should improve the property's performance and result in higher future revenues through a more stable tenant base. While I believe that the aforementioned change will reap long-term benefits, there may be some short-term reductions in apartment revenues. I would be happy to discuss this issue with you at your earliest convenience.

In the meantime, please do not hesitate to contact me if you have any questions

The Watson & Taylor Companies: 214/386-9070

Corporate Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin, Texis 75244-2398 Mailing Address: 4015 Rek Line Ruad | Dallin,

WALLONG WALLER

Mr. Henry P. Lorber October 14, 1986 Page 2

or comments. Thank you for your time and consideration.

Sincerely yours,

THE WATSON&TAYLOR COMPANIES

R. Michael Berry

RMB/nb

Enclosures: As stated

lavler/N.D.	allasürbanCenter				IMMEDIATE I	MOITAGIUDI	BULK SALE OF UNDEVELOPED LAND
planation		Qtr	Beginning	3	4	1	
	WindscapeEWindridge NET CASH REGUIREMENTS	Year	Balance	1986	1786	1937	
	Apartment operations				(175.000)		
12.00%	Interest JMB Interest FirstSouth			477,506	464.256	455.006	
by res	Tazes			400.125	260.860	285.929	\$
	Planning&PreBevelopment	:		10.000	10.000	10,000	
	Site development			0	0	0	
	Total borrowines			887,631	802.115	555.934	
	Less accruals for inter	est		400.125		295,928	f
	Net cash requirements/(fl	mili before					
-	principal repayments	DM1 DEIGLE		427,506	\$41.256	270.006	2016
1	Principal repayments (JRB)		275,000	375,000	375,000	2012
							11. 12 th 15 th
	Het cash requirements/(f)	(100		862,506	916.256	645,006	
1	PROJECT SALES						
	Site sales expressed in Sales price per FAR	terms of FA	R			1,592,892 17,00	الهوائي ما الدرائي و العامل الموادر الهوائي المستراد المرائي الأراض المراث الم
	setes butte bet Lwa					17.00	
	Sales proceeds			0		27.079,166	
	Selling expenses	4.0	OI	0		1.035,167	÷.
	Net sales proceeds			0		25.995.999	
	Less repayments of inde	t tedness		0	0	25.995,999	•
	PROFIT/(LOSS) Cash					(11.225,889)	
	PROFIT/(LOSS) Accrua	ıl				(946,913)	
	PROFIT/(LOSS) Total					(12.172.802)	•
	malysis of Indebtedness/						
1	Windscape&WinJridge JMB Notes						*
	Beginning balance			15.916.863	15.541.863	15.166.363	
	Repayments	٠.				(15.106,803)	
	ertin Arlana		0.000.00	VECTOR COST	15 545 547		
	Ending balance FIRSTSOUTH,F.A. Notes		15,716,863	15,541,063	13,156,063		
	Beginning balance			20,006,250	20,863,764	21,785,020	
	Borrowings/(Repayments	;)		362,506	216.256	0.559,131)	
	Ending balance (advanc	ed)	20.004.250	20,868,764	21,725,020	225,389	
	Custing Desemble 13074me			- Contractive	ELF FEINER		•
	Accrued interest (cumu	lative	0	400,125	660,985	946,913	
	Total indepteuness to	FIRSTSOUTH	20,000.253	21,268,389	22,446,004	12 172,602	
ī	otal Indebtedness	-	25, 923, 121	36,010,752	37.612.867	12,172,802	
	SF of remaining land		50.63				
	SF of remaining developme	ent rights	22.55		23.61	0.00	
	emaining land (sf)		709,465	709,465 1,592,392			
	emaining FAR (sf) Cost of funds		1,372,072	8,001		-	
				0.904	. 5.00	. 3.234	UC-297
							116.71

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15.50 15.5						(195,000)	(195,800)	(195,000)	(195,000)	(195,000)	(195,888)	(195,000)	(195,000)	(195,000)	(195,000)
10,000 1	7.0		•	:		¥.	38. 38. 38. 38. 38. 38. 38. 38. 38. 38.	3.	7.	3	7,7	3.7	13,74	42,74	3
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15.57 15.58	٠	PlaningStreBerelmount			19,600	8.0	8	9.0		9.0	9.0	8,8	2	2	8,8
11 12 13 14 15 15 15 15 15 15 15		Site development			-	-	-	-	-	-	-	-	-	-	Ì
10.00 10.0		Tatal berrowings Less accruals for interc	¥		887,631 688,125	902.115 760,668	25.25 25.75 25.75	25.52 27.75	578,727 111,971	315,275	596,458 117,782	566.177 241,421	618,383 36,10	20.24 26.28	646.911 280.155
145, 166 256 756 756 756 756 757 757 757 757 757 7		let cash rewirements/(fli principal repayments Principal repayments (AM)	e) kfer			27,12 85,62	23.52 25.88	28.78	%/ %Z	¥.74	25,22	¥.		21.72	2
1,15,100. 1,71,101. 1,71,1		Hel cash respirements/lflo	î		962,596	982'986	48. 645.98	258.734	25,75	¥	24,73	22.22	228,736	81,13 82	28,74
11.50.000 1.50.000		PROJECT SALES Site sales expressed in Sales price per FAI	terns of FIA												1,592.872 82.52
105.000 0 0 0 0 0 0 0 0 0 0 0 0 0 0 0 0 0		Sales proceeds Selling expenses	7.80				••	••			••		••	••	15,848,073
155,000 14,71,00 14,7	* 4	Hel sales proceeds Less repayments of inde	*Indeess		••		••	••			••				N.486,470 N.486,470
10,5,000 1,70,000		FL-F11/11.053) Cash Fliv [1/11.053) Accraa P10F11/11.053) Total	-												(3,486,864) (3,648,240) (9,146,326)
1,711,521,11,721,522,11,721,523,11,721,721,721,721,721,721,721,721,721,		analysts of indebledness/ lindscapethindridge Juli motes Pequang balance Repayents			15.916,863 (375,800)	15,541,863 (375,888)	15,144,843	14,791,843	14,791,863	14,791,863	58,195,4	14,791,863	16,791,863	14,71,863	14.791.8 14.791.8
1.75.50 7.13.10 7.13.17 7.54.13 7.54.1		Ending balance		15,916,863	15,541,863	15,166,963	14,711,863	14,791,863	14,791,863	14,791,863	14,791,863	14,791,863	14,791,863	14,791,863	
Ending balance (name) Abbat 20 20,000 20		FIESTSOUTH, F.A. Motes Deginates belance Dorrowings/(Repayments)				38,848,74	21,785,628	22,420,005	27,621,772	22,92,53 24,25	25,022	25,751,949	28,085	78,248,561 573,756 (24.001.9 19.335.01
Excred interest (conclusive) 6 doi:15 64/805 94,813 1.301,300 1.501,700 1.504,500 1.507,500 1.504,500 1.507,500 1.504,500 1.507,500 1.504,500 1.507,500 1.504,500 1.507,500 1.504,500 1.50	٠, .	Ending balance (advance	7	22,28	20,948,764	21,785,628	23,439,626		22,00,23	23,692,293	23,751,809	28,689,16	N.260,567		8.
	• ,	Accrued interest (cum	dative)	-	88 ,13		286,933	1,241,397	1,553,270	1,848,887	2,786,588	2,547,938		1	3,660,260
Final Indebtodes		Total indebtedness to	FIRSTSBUTH	23,004,258	21,260,007	22,446,604	23,376,939	23,439,889	21,588,815		25,557,558	26,533,733	27,176,638	28,114,622	9,164,286
The Way of a free land of the Way 2 and 2		Total Indubiedhess		35,423,121	36,010,72	37,612,847	39,164,862	38,721,95	39,277,63	8,122,93	127,00,421	A, 25, 58	38,38	42,985,885	9.16
709,465 709,465 709,465 709,465 709,465 709,465 709,465 709,465 709,465 11,902,000 11,902,000 11,902,000	sf: 789,467 sf: 1,592,897	S PS of resistes lad 2 PS of resistes developmen	n rights	22.52	2 2	, z z z	3 E	32	8 3 Z	32	3.8	3 K	2 X	z z	33
		Densians land (sf) Densiaing FAR (sf)	110	1,372,872	1,972,673	79, 65 1, 582, 653	29,46	1,992,992			38,465	28,58,1 58,98,1		¥ %	•••

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espissotion	Bindscapetalindridge Four	Palante Palance	" ₹	-I	- <u>ē</u>	~ ₹	~≧	- <u>8</u>	- <u>F</u>	~ 2	. Ē	- <u>E</u>	-₽	~ <u>E</u>	- <u>\$</u>
22 M			2 2	E # Z	(15.88) 28.88 28.08	18.25 26.25 26.35	(35.28 25.24 12.24	2.2.2.2.2.2.2.2.2.2.2.2.2.2.2.2.2.2.2.	E 2.0	£ 3.3 € 5.6	1 2 2 3 2 2 3 3	2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2	€ 3.8 § 5.8	20.25 20.36	1
	FlamingsProfervlapens Site development		1	1.	i.	8.	i.	13.	1.	1.	1-		1.	# # F	# F
	lotal berraungs Less acreals for interest		807,431 400,125	21.55 24.03 24.03	55.73 85.78	31 K	578.72 241.97	25 25 25 25	996,038 330,782	341,62	28.00 26.10	. 937.384 364.88	646.701 20.701	1,58,02 28,78	14.14. 14.44
	Net cash requirements/(flus) before principal represents. Principal represents (AM)		3.55 3.65 3.86	2.5 2.5	# # 25.55	25. 25.	3	*	35	3	2,	3,12	3	1.1.1.1.1.1.1.1.1.1.1.1.1.1.1.1.1.1.1.	1 M
	Ret cash requirements/(flow)		36.58	916.256	46,86	228,7%	28.78	¥.7	25.75	22. 22.	22.22 27.32	3	28,74	28,74 15,526,199	4
	POWET SALES Site sales expressed in teres of FAN Sales price per FAN	_													
	Sales proceeds Selling expresses 4.000	p		••										••	
	Met sales proceeds Less reparents of indebtedness			••											
	Pbd 11/11855) C4sh Pbd 11/11855) Accust Pbg 11/11855) Istal	-													
	majess of ladebrehess/ linktramelinds der Mitter bestellen der Bestellen belance Represels	•	15,916,863	18,141,843 (488,241)	15,14,180 135,880	14,781,863 •	H.M.H.	38,19.2	פיותיא מיותיא	3 K. A.	7	H.M.M.	H,791,643 14,791,643 6 (H,791,643	14,791,863 14,791,863	
	Ending bulgace	15,916,863	15,916,863 15,541,863 15,166,863		14,791.863 14,791.863	14.791.863	14.791.863	(,m,m.)	14,791,863 14,791,863 14,791,863		14,791,863	14,791,863	14.7M.AL	-	•
	FISTMENT, A. Beles Sepanies belance Serradops/(Repayments)		2 3 2 3 2 3 3 3	25,248 25,248	71,745,420 645,836	20 E E E E E E E E E E E E E E E E E E E	27.72 27.72 27.72	2 Z Z	27, 652 26, 783	28,74,865	26,255 25,755	25.25. 27.72	28,78	25.100.473 15.706.150	2. 4 2. 4 3. 4 3. 5
	Ending balance (advanced)	30,004,756	38,868,74	21,785,000	Z2.CM, 22 SM, 20,480, 22, 907, SU	20,484,52	22,00,52	23,008,293 23,7N,500	21,74,000	71.007,EE	N.386,56	24,144,97	25,188,473	41.68.82	a,83,4
	Accrued interest (comulative)	•	406,125	188.985	£,9	94,913 1.N1.387	967,536,1	1,846,807	2,786,580	2,542,538	2,980,67	3,272,100	3,640,346	4,882.08	4.779.144
	Total indebteders to FIESTSWITH	٠.	28,064,236 21,344,669	22,444,004	23,276,939 23,939,689 24,366,865	23.939.000	7,580,855	25,341,168 25,952,538		26,525,738	2,1X,438	38,114,882	28,746,933	B. 23.28	A. 72. St.
	letal ladeluders		BM*04C19 139*04C190 134*151100 047*24C101 255*122*05 28*159*05 28*1519*05 28*1519*05	79,412,867	38,148,002	39,721,952	M.272.43	132,963	40,745,421	38,98	41,746,381	42.48.50	C. 582,78	S. 69.24	#.78.3M
100 A	str. 70,403 PS of resumes land str. 1,502,009 PS of resumes development rights amounted that (15) Benium PS (15)	3 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2		2.0 2.0 2.0 2.0 3.0 3.0 3.0 3.0 3.0 3.0 3.0 3.0 3.0 3	3 2 2 3 2 3 3 3 2 3 2 3	2 2 8 3 8 3 8 3 8 3 8 3 8 3 8 3 8 3 8 3	15.30 15.40 15.00 100.45 15.00	3 2 3 E 3		8 X 25 X 25 X 25 X 25 X 25 X 25 X 25 X 2	******	3 X X X X X	2.2 2.2 2.3 2.3 2.3 2.3 3.3 3.3 3.3 3.3	1007 1027 1027 1007 1007 10 1071007 1047007 1047007 1047007 1047007 107100 107100 107100 107100 107100 10710 10710 10710 10710 10710 10710 10710 10710 10710 10710	2.5 2.5 2.5 2.5 2.5 3.5 3.5 3.5 3.5 3.5 3.5 3.5 3.5 3.5 3

explanation UtoScaretilindridge Vear	Ĭ	- Ē	~ 1	"£	- <u>E</u>	-₹	~Ē	" <u>E</u>	Ē
M. I CAN MODINEMIS 12.00 Interest - Interes	34,96	10, 88, at		* ° 12, '23, '41	3,5,5		777,231		177,78 85,283
Site development Total berowings	3,424,668 1,424,668	2,266,756	10,74	512,70	28,117	3/2,591	349,772	187,572	238,028
rask requirements/(flow) before practical repainents fractical repainents (JNB)	2,741,426	576,353,1	10,000	10,000	238,460	10,000	10,000	10.000	86,34
Nel cash requirements/(flow)	2,741,426	1,656,973	10,000	10,000	238,400	10,000	10,000	10.000	40,248
PRUICE SALES Sales servessed in teres of FAB Sales price per FAB	18,537 31		318,578		316,578		114,578		18.57
Sales proceeds Selling espenses 6,400	0,979,846		34,542		376,875		0,418,440		10,119,342
Net sales proceeds Less reparents of indebtedness	0,639,847		9,071,039	•	9,85,41	••	10,001,703		8. 13. 3 18. 21. 78
PAG 17/1.055 Cash PAG 17/1.055 Kernal PAG 17/1.055 Intal PAG 17/1.055 Intal	٠.								526,925 (531,317,8) (825,225,7)
Amalesis of Indebledmens/ Handscapetiside idea Jul Booles Requanted belace Reparents		. •	•	•		•	÷-	•	•
Ending balance F1951900H.F.A. Motes Beginning balance Beremings/(Represents)	(15,879,221)	25,223,407 34,135,186 (3,894,221) 1,656,975	28,702,161 28,730,122	28.730,522	28,740,322	19,451,790	19,463,290	10,000	9,481,587
Ending balance (advanced)	36,135,186	17,792,161	28,730,322	28,740,322	19, 653,299	19,443,230	9,471,587	9,461,587	(126, 621)
Accreed interest (comulative)	5,402,197	6,011,940	111.64.711	7,152,692	7,455,447	8,008,039	6,340,610	8,538,402	6,716,182
Total indebtedness to FIRSTSOUTH	11,537,333	43,804,129	35,300,032	35,892,813	27,103,727	27,471,338	17,812,387 18,019,990	18,019,990	7,756,230
Total Indebtodness	41,537,373	43,804,129	15, 340,012	35,892,813	27,100,737	27,101,328	17,812,197 18,019,990	18,019,990	7,754,230
1 1,372,862 PS of resulting land 1 1,572,862 PS of resulting devilement rights Penalting land (47) Internating for (47) East of land	22.2	er was	11.00 10.00	2. 2. 2. 2. 2. 2. 2. 2. 2. 2. 2. 2. 2. 2	20.00 20.00 20.00 20.00	8.00 40.12 50.12 7.15 7.15	25.07 25.97 16.193 26.534 25.17	25.55 25.56 26.59 26.59 26.59	333

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BENT TREE CENTER

ASSUMPTIONS: BENTTREE ADDISON - WORKOUT PROFORMA

1 BASED ON

15-Aug-86 MEETING WITH HENRY LORBER

2 CONSTRUCTION DELAYED UNTIL

7 TH QUARTER

3 CONSTRUCTION PERIOD

12 MONTHS

4 TOTAL REVENUE 47,300,000

5 LAND BASIS ON 01-Oct-86 IS 32,300,000

6 BASIC IMPROVEMENTS COST IS

500,000

7 PLANNING & ENGINEERING 15.00% OF BASIC COST OR

75,000

8 MARKETING COST

0.50% OF GROSS REVENUE OR 236,500

9 MANAGEMENT CONTINGENCY 1.00% OF BASIC COST OR

8,115

10 MANAGEMENT EXPENSE

3.00% OF BASIC COST OR

24.588

1 ANNUAL REAL ESTATE TAXES 195,000

2 POINTS & FEES

0.00% OF TOTAL INITIAL FUNDING

3 INTEREST RATE PAID AT: 0.00% RATE

INTEREST RATE ACCRUED AT: 5.00% RATE

QUAIL VALLEY

Quail Valley - Business Plan

The Quail Valley tract is located in Missouri City, Texas, near Houston. It contains 87,250 square feet suitable retail or light industrial development. The attached proforma anticipates the sale of this property in two increments within an eighteen month period.

BUSINESS PLAN

S.W. CORNER LEXINGTON/FM 1092

MISSOURI CITY, TX (QUAIL VALLEY)

Total: 87,250 s.f.

Gas/Convenience: 30,000 s.f. at \$12 = \$360,000 - 15 months

*Currently countered Circle K Contract at \$12.50 p.s.f.

57,250 s.f. at \$5 = \$286,250 - 18 months

\$646,250

x .95

\$613,937.50

FRISCO

ASSUMPTIONS: FRISCO - WORKOUT PROFORMA

1 BASED ON 15-Aug-86 MEETING WITH HENRY LORBER

2 TITLE X FUNDING (PAYDOWN) DOES NOT OCCUR

3 CONSTRUCTION DELAYED UNTIL 3 RD QUARTER

4 CONSTRUCTION PERIOD 15 MONTHS

5 TOTAL REVENUE 125,000,000

6 LAND BASIS ON 01-Oct-86 IS 68,500,000

7 BASIC IMPROVEMENTS COST IS 6,000,000

8 PLANNING & ENGINEERING 15.00% OF BASIC COST OR 900,000

0.50% OF GROSS REVENUE OR 9 MARKETING COST 625,000

1.00% OF BASIC COST OR 10 MANAGEMENT CONTINGENCY

3.00% OF BASIC COST OR 11 MANAGEMENT EXPENSE 228,008

12 ANNUAL REAL ESTATE TAXES 450,000

13 POINTS & FEES 0.00% OF TOTAL INITIAL FUNDING

14 INTEREST RATE PAID AT: 0.00% RATE

15 INTEREST RATE PAID AT: 6.00% RATE

75,250

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MARKET. LINE SHEEK LINE, CLESSER COSTS	5.0 YEAR 1.89 (2.4.5/.5)	1,250,000	1,81,92	27.38.59 21.38	1,582,612	131,181	5.101.70 517.10	# E	ää	1.78.460	1.78.40	1, 15. 10.10	1,74,457	1,754,467	7.78,467	7,756,467	1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1	7,78,4er 27,45	1. E	1,786,467 271,454		., 75, 98 4, 75, 98
MATERIAL STATES		1,386,750	1,005,550	2,611,049	1,346,936	4,10,79	5,010,00	S. MO, 402	ij	7,444,933	1,404,733	1,404,537	1,48.93	1,44,93	18.8	1,00,11	1,444,523	7,48,58	1,48.00	1,444,933	7,404,933	39,625,000
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TOTAL COST		68, 610, 750	12,270	1,566,684	1,578,665	1,574,824	1,579,140	1,500,455	Ē	28,28	:	151,782	28,28	151,782	181,282	131,782	. M.	151,382	151,382	181,282	38,762	78,45,73
MAJECT CHES FLAR		(67,412,546)	. M.M	. M.	 E. 33	2.60.53	3,434,83	, 38, 03	ä	1,311,651	7,70,69	1,33,65	7,330,65	1,310,68	7.B.S	1. 18.	, m.	1,330,651	1,330,661	1,333,651	1,446,151	42,199,243
1684 AMAYRIS: 1581 MAJER FIRSTON'N SAV. 168871: 64,500,000	005181, Det., 60, 00, 00, 00, 00, 00, 00, 00, 00, 00	3 2 2 2 2 3 3 2 3 3 2 3	17,212,500	15,566,21 1,566,644 (0.611,049)	4,986,963 1,578,663 (1,386,839) (62,78,671 1,574,624 (4,102,799)	16,186,687 1,578,110 (5,016,00.)	24,245, 20,245, 25,046,0	20, 63 20, 63 30, 73, 73	28.181 281.181 51.181 (US. #4.17)	38,623,414 151,242 (7,444,533)	7,282,78 26,282,0	13,656,113 15,282 17,444,833)	54,553,81 58,181 (000,000,1)	5,38,82,7 55,282,17 (68,382,7)	1,986,161 151,282 (2,186,483)		181.202 (181.202)	251,282 286,183	28(,121 (584,121)	28, 36 20, 36	
		67,412,988	18,64,211	E. H. N	R.74.GI	18,01	175.713	\$2,490,716	1,181	M.633,414	31,389,74	21,956,113	16,622,462	1,784,612	1,88,161	-	-	-			•	
LITTEREST ACCREM, (BATE)	£.	4,044,750	1,603,783	11,859,945 15,627,636		19,236,627	21,44,172	75,793,615	M,551,	30, 000, Att	32,745,838	M.163,196	35, 186, 546	15,717,017	26, 253, 102	35,655,102	<u>.</u>	:n,m,646	18,611,801	1,044,713	2,071,745	
STEEDTIONS SETTION ONL PROCESS IN	METER SIMPLE	•	•	-	-	•	*	•	<u>l</u> .	•	THE STATE OF	•	•	•	-	5.37E.489	- E	1,380,681	1,200,651		1,446,151	42,159,342
- 1981 ACCIONAL PARTIEREN	8.8 8.8 8.8	••	••	••				••			••	••	••	••	••	5,760,565	_	6.8 8.8 8.0	1.8 .8	6.946.98 66.98	2,871,745	35,182 6,341,645
GENERATIVE: COST		62,619,750	.648,750 64.741,026 71,347,784 71,578,785 73,453,413 75,022,343 75,645,750	70,700,704	11,978,369	13,653,103	N. 022,300.7	76,615,750	2		N, 544, 155 71, 865, 437 71, 214, 719 71, 346, 601 71, 519, 343 77, 671, 601, 607	77,216,719	77,388,081	71,519,263	77,676,565		m,m	178,128,411	74.77.00	78.4% US	78, 465, 75g	•
SELATERA MUK		123,738,988 L	100,120,111 510,880,811 113,080,811 1130,000,1151 900, 1151 1151,1151 1151,1151 1151,1151 1151,1151,1151,1151	19,000,074 1. St. 28	15.58E,012 12.38	H. 252, 206 M	H.000,540	91,999,454 12.58	E	66, 220, 476 65. 76	7.564.00	71,544,641 60,647,642 61,651,255 54,254,646 64,536,441 36,751,504 71,655,538 64,536 44,536 44,536 45	12,651,255 25.05	84,284,848 17.78	M.531.441	34,742,654 0.54	. 85.0 8.0 8.0	272,288,281 1.0	15,512,614 B.B	1,756,467	- 5	

KELLY BOULEVARD

Kelly-Blvd. Summary

. Property

The property consists of approximately 20.846 acres of Townhouse-2 zoned property which allows 8 dwelling units per acre. The property is located in north Dallas at the northeast and southeast intersections of Kelly-Springfield and Timberglen Drive. The property is located in the City of Dallas, and the residents will attend the highly recommended Carrollton Independent School District.

. Market Conditions, Marketing Agenda and Project Recommendation

At the present time, the market demand for attached townhomes is rather soft. However, the demand for low cost single family detached dwelling units priced below \$120,000 has remained fairly strong. Therefore, in today's market, the prudent development of this property would be for single family detached dwelling units.

The marketing agenda for the property would consist of final platting the site in 1987 with the commencement of development in the first half of 1988. The attached proforms assumes that the lender will fund the necessary development costs and the single family interim construction costs. The proforms also assumes that the lender will pay the home builder a 4% fee with the lender receiving the remaining home sale proceeds.

Attached is an offer of sale submitted by the Housing Authority of the City of Dallas for \$114,736. The attached proforma assumes that the lender will consent to this sale which should occur in the first half of 1987.

Page i

KELLY-2 MVT 1/18/87

WATSONETAYLOR COMPANIES KELLY BOULEVARD JU PROPERTY PROJECTED CASH FLOW PATIO HOME LOT SALES

		987			1			990			1992	
STATISTICAL INFURNATION:	1ST HF	2ND HF	1ST HF	2ND HF	1ST HF	2ND HF		2ND HF		2ND HF	1ST HF	TOTAL
PATIO HOME LOTS	0	0	() 10	15	15				26	0	14:
CASH FLOW:												
SEGINNING DEBT BALANCE	4365911	4307649	4315149	4652632	5087283	4619574	4067192	3160419	2176332	1166194	57212	
CASH IN:												
SALES - LAND OR LOTS	-114736	0	0	-280000	-420000	-420000	-700000	-700000	-700000	-728000	0	-4062736
INTEREST EARNED UN TAKE-DOWN	0	0	0	-4219	-30723	-54370	-130890	-172027	-200651	-253105	Ó	-845985
INTEREST EARNED ON TAKE-DOWN CASH ON HOME SALE \$6,000 EA.	0	0	0	-36000	-66000	-90000	-120000	-132000	-150000	-150000	-102000	-846000
CASH OUT:												
SALE CLOSING COSTS	11474	٥	0	5684	9014	9487	16618	17441	18013	19622	0	107353
SALE COMMISSION (0%)	0	0	0	. 0	. 0	. 0	0	0	0	0	0	
ENGINEERING	0	5000	40000	52766	. 0	. 0	0	0	0	0	0	97766
WATER	0	0	33245	77571	٥	0	. 0	0	0	0	0	110814
SANITARY SYSTEM	0	0	42602	99406	0	v		0	0	0	0	142008
STURM SEWER	0	0	19177	44746	0	0	0	0			0	63923
PAVING	0	0	154959	361572	0	0	0	0	0	0	0	516531
ELECTRIC	0			88125		0	0	0				88125
GAS				20000			0	•				20000
MISCELLANEOUS & TAXES	45000	2500	47500	5000	40000	2500	27500	2500	22500	2500		197500
CASH DISTRIBUTION	0	0	0	0	0	0	0	0	0	0	0	0
OMSH FUNDED BALANCE	4307649	4315149	4652632	5087283	4619574	4067192	3160419	2176332	1166194	57212	-44788	
CCRUE INTEREST & C.O.F.	228494	119538	128559	147300	150423	142320	120963	94161	60085	23127	235	1215205
TASH FUNDED + ACCRED INT.	4536143	4663181	5129223	5711173	5393887	4983825	4198016	3308090	2358037	1272182	1170417	
CASH FUNDED PROFIT (LOSS)											44788	

TASH FUNDED + ACCRUED INTEREST PROFIT (LUSS)

(1170417)

ASSUMPTIONS:

^{1.} SALE 141 LOTS @ \$28,000 PER LOT CASH & TAKE-DOWN INTEREST @ P+2X BEGINNING @ 11X AND INCREASES BY .25X PER HF. YR.
2. ASSUME LEMBER INT. CARRY ACCRUES AT COST OF FUNDS (C.O.F.) BEGINNING AT 5.25X AND INCREASING AT .25X PER HALF YR.
3. ASSUME ON INTEREST CARRY A 365 DAY YEAR & SOX OUTSTANDING BALANCES FOR ADVANCES AND SALE PROCEEDS.

^{4.} ASSUME 1ST SOUTH LOANS THE INTERIM FUNDS ON A \$925,000 REVOLVING LINE WITH A MAX. EXPOSURE OF 9 HOMES.

^{5.} ASSUME NO SALE COMMISSION.

^{3.} INSSURE NO STREET CHARLESSION.

6. ASSUME PRINE BEGINS AT 8% AND INCREASES BY .25% PER HALF YEAR.

7. ACCRUED INTEREST CALCULATION SEGINS ON 71/186.

8. ASSUME SALE TO HOUSING AUTHORITY OF THE .65% AC. PARCEL IN 1987.

7. THE WHITER, SANITARY, STORM & PAVING COSTS CONTAIN A 5% CONTINGENCY WHICH TOTALS \$39,681.

March 24, 1987

The Honorable Fernand J. St. Germain Rayburn House Office Building, Room 2108 Washington, DC 20515

Re: Comments on Testimony Given during Hearings on H. R. 27 on March 3, 1987

Dear Mr. St. Germain:

During the March 3, 1987 Hearings on H.R. 27, Mr. Carper requested that I submit comments for the record on changes recommended by FADA in this legislation. My comments are as follows:

FADA Recommendation #1

FADA recommended that language in the bill which makes FADA a mixed-ownership Government Corporation be deleted. The FADA is subject to audit requirements for federal savings and loan associations and a proposed modification would subject FADA to audit by the GAO on demand.

<u>Comment</u>: I concur with the FADA recommendation. FADA should be afforded maximum flexibility to accomplish their stated mission within the constraints of sound business practices.

FADA Recommendation #2

FADA recommended that provisions of the bill which make FADA subject to the "Sunshine Act" be deleted.

<u>Comment:</u> I concur with the FADA recommendation. FADA would be rendered ineffective if negotiations with borrowers were subject to public forum.

The Watson&Taylor Companies: 214/386-9070
Corporate Address: 4015 Belt Line Road
Dallas, Texas 75244-2398 Mailing Address: P.O. Box 819092
Dallas, Texas 75381-9092

Hon. Fernand St. Germain March 24, 1987 Page Two

FADA Recommendation #3

FADA recommended deletion of provisions of the bill requiring submission of detailed quarterly reports to the House and Senate Banking Committees on the basis that such reports would be duplicative of FSLIC reporting requirements.

<u>Comment</u>: I concur with the deletion of duplicative reports. If, however, the reports made to FSLIC do not contain the types and levels of data desired by the Congress, then such a requirement is not duplicative and should be furnished by FADA.

Sincerely yours,

WATSON&TAYLOR REALTY COMPANY

Lionel J. Nowotny

President

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Copies to:

Congressman Thomas R. Carper 131 Cannon House Office Building Washington, DC 20515

Congressman Steve Bartlett 1709 Longworth Building Washington, DC 20515



United States General Account iting Office shington, D.C. 20548

Accounting and Financial Management Division JAN 2 0 1987

The Honorable Fernand J. St Germain

Chairman, House Committee on Banking,

Dear Mr. Chairman:

Finance and Urban Affairs

ARCHINED . We have reviewed H.R. 27, a bill to provide additional resources to the Federal Savings and Loan assurance resources to the Federal Savings and Loan insurance Corporation The bil contains a provision which states that whether or not government funds are invested in the Federal Asset Disposition Association, such Association shall be treated, for purposes of sections 9185, 9187, and 9188 of title 31, United States Code as a mixed-ownership Government corporation which has capital invested by the United States. We are pleased to provide comments on that provision. Corporation

We strongly endorse the effect of sec. 7 (a) of H.R. 27 which will make the Federal Asset Dispos tion Association (FADA) subject to the same oversight by the General Accounting Office as any other mixed-ownership government corporation, regardless of the status of any United States investment in FADA. FADA s a wholly-owned subsidiary of the Federal Savings and Loan Insurance Corporation (FSLIC). By resolution in November 1985, the Federal Home Loan Bank Board Chartered FADA under sections 496 (a) and (b) of the National Housing Act of 1934. FSLIC is the sole owner of FADA's capital stock, amounting to an investment of \$25 million.

The purpose of FADA, according to the Federal Home Loan Bank Board, is to manage and liquidate nonperforming assets on behalf of FSLIC. In meeting this defined purpose, FADA acts behalf of FSLIC. In meeting this defined purpose, FADA acts as an agent of or on behalf of FSLIC or the receivership for a failed savings and loan association. In such capacity it performs functions originally env sioned as being performed by FSLIC. The use of FADA, or any other contractor, subcontractor, or agent should not render any aspect of FSLIC's management, or the liquidation of assets acquired from failed or troubled savings and loans associations, impervious to GAO investigation.



In conclusion, let me add that GAO will closely monitor the activity and financial performance of FADA as well as FSLIC's efforts to cope with the large number of savings and loan associations that are doomed to failure as a result of their poor quality loans and other assets. The continued interest and support of the Committee in this important effort is greatly appreciated.

Sincerely yours

Frederick D. Wolf

Director

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March 20, 1987

Honorable Fernand J. St Germain rman ittee on Banking, Finance d Urben Affairs . House of Representatives ington, D.C. 20515

Mr. Chairman:

providing, at Congression Bartlett's request, a copy of the ral Asset Disposition Association's Business Conduct Policy Interested-Director Transactions Policy.

e Policies set forth high standards of integrity and professional uct to avoid conflicts-of-interest and the appearance of such licts. The FADA Board of Directors and senior management have e Policies under continual review.

Very Sinterely

Roslyn B. Payne President and CEO

chments

tjs

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BUSINESS CONDUCT & EMPLOYEE RESPONSIBILITIES POLICY

I. PURPOSE AND SCOPE

The Association has adopted the following Business Conduct Policy to ensure that officers and all other employees of the Association maintain the highest possible standards of conduct in their business and personal affairs. It is the responsibility of all employees of the Association to read and thoroughly familiarize themselves with the rules and guidelines embodied in this policy. Each employee will be asked to acknowledge that they have both read and understand the policy and, will be required to complete a disclosure form which covers present and past dealings. This policy applies to all employees at all locations of the Association, unless otherwise noted.

II. GENERAL POLICY

The maintenance of extremely high standards of honesty, integrity, impartiality, and conduct by officers and employees of the Association is essential to assure the proper performance of the Association's business and the maintenance of public confidence in the Association. The Association expects all employees to uphold and meet these high standards and to use their best judgement, based upon the standards set forth in this policy, to avoid misconduct and conflicts of interest.

In general, employees shall avoid any action, whether or not specifically prohibited in this policy, which might result in or create the appearance of using his or her position for private gain, giving preferential treatment to any person, losing complete independence or impartiality, or making Association decisions outside official channels. Employees shall not take any action that would adversely affect the confidence of the public in the integrity of the Association and shall not engage in conduct prejudicial to the Association, including criminal, dishonest or immoral conduct.

III. PARTICULAR CONFLICTS OF INTEREST

The Association expects employees to avoid conflicts of interest at all times. A conflict of interest occurs when an employee's personal or financial interests interfere with or, to a disinterested, reasonable observer, may appear to interfere with his or her duties and responsibilities to the Association.

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The same prohibitions imposed on employees under this policy apply to certain corporations or other organizations in which an employee has an interest. If an employee has one of the following interests in an organization, that one of the following interests in an organization, that corporation or organization is subject to the same conflict of interest restrictions applicable to the employee individually. Therefore, for example, just as an employee may not use confidential Association information for private gain, a corporation with which an employee has one of the following relationships also may not use confidential association information for private gain, a corporation with which an employee has one of the following relationships also may not use confidential association in the confidential association in the confidential association in the confidential association in the confidential association in the confidential association in the confidential association is subject to the same conflict of interest restrictions applicable to the employee may not use confidential association in the confidential association in the confidential association is subject to the same conflict of interest restrictions applicable to the employee may not use confidential association information for private gain, a corporation with which an employee has one of the following relationships also may not use confidential association information for private gain, a corporation with which an employee has one of the following relationships also may not use confidential association information for the confidential association in the c information to benefit itself. organizations in which an employee: This section applies to

- Is an Officer;
 Is a general partner;
 Is a limited partner with at least a 5% interest or with other employees has at least 10% interest or
- 4. Owns at least 5% of any class of stock or with other employees owns at least 10% of class of stock.

Rules pertaining to specific conflict of interest situations follow. If an employee has any question or doubt as to what circumstances might constitute a conflict of interest, the employee is encouraged to and should consult with the Director of Human Resources or General Counsel.

A. Financial Interest

1. General Interests and Transactions. An employee shall not have a direct or indirect financial interest that conflicts with or appears to conflict with his or her duties and responsibilities to the Association An employee holding such a financial interest, on his or her hire date, shall as soon as practicable either: 1) place all such holdings in a "blind trust"; or 2) dispose of them without causing undue hardship. An employee also shall not engage in, directly or indirectly, a financial transaction as a result of, or primarily relying upon, the employee's position with the Association or information obtained through his or her employment. In addition, employees shall not acquire an interest in real property to which the Association's business is in any way related and shall not receive a commission, fee, or "kickback" for any transaction

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conducted for the Association. Employees also may not on behalf of the Association make or be involved in any transaction, contract, or agreement with individuals or organizations with whom the employees has a personal or family financial interest. Further, default on a personal liability obligations to an FSLIC/FDIC insured institution constitutes grounds for the Association to (a) refuse to hire an individual who is otherwise qualified and (b) dismiss an FADA employee from employment with the Association.

Except as otherwise provided in this policy with respect to stock and loans*, employees are permitted to have financial interests or engage in financial transactions to the same extent as a private citizen not employed by the Association, including investment in savings accounts with federally-insured savings and loan institutions ("Savings & Loans") on the same terms and conditions available to the employee if he or she were not an employee of the Association.

2. Stock. An employee shall not purchase permanent capital stock of a Savings and Loan or any securities of a holding company of a Savings & Loan. An employee holding such securities, on their hire date, shall as soon as practicable either: 1) place all such securities in a "blind trust"; or 2) dispose of them without causing undue hardship.

However, the purchase, acquisition or holding by an employee of capital stock in a Savings & Loan is not prohibited by this policy after date of hire when:

1) such stock was used or sold to the employee in connection with the conversion of a Savings & Loan to a stock institution, provided such stock was issued or sold to the employee only because he or she was a savings account holder in the Savings & Loan prior to such conversion; or 2) such stock was issued to the employee by reason of the death of another person.

- * See Section III.B, below, for separate discussion of loans.
- B. Gifts, Favors, Entertainment, and Loans
 - Prohibited Activities. As a general matter, gifts, favors, entertainment and loans must not

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influence or appear to influence the recipient employee's judgment. Employees should avoid accepting or seeking any of these items if the acceptance might cause a reasonable observer to question whether the item was given to the employee in the ordinary course of business or was given to gain an advantage with or special treatment from the Association. More specifically, employees shall not solicit or accept directly or indirectly, any gift, gratuity, favor, entertainment, loan, or other thing of more than nominal monetary value from a person or entity who:

- a) Has or is seeking to obtain contractual or other business or financial relations with the Association, the Federal Home Loan Bank Board ("FHLBB"), or the Federal Savings and Loan Insurance Corporation ("FSLIC");
- b) Conducts operations or activities that are regulated by the FHLBB or the FSLIC;
- c) Has interests that may be affected by how an employee handles his or her official duties; or
- d) Is an officer, director, or employee of any institution which is a member of a Federal Home Loan Bank, a member of the FSLIC, a trade organization comprised of Savings & Loans, or a Savings & Loan holding company.
- Permitted Activities. This policy does not prohibit the following activities and employees may:
 - a) Accept, from Savings & Loans in their ordinary course of business, so long as the employee is granted terms no more favorable than would be available in like circumstance to persons who are not employees of the Association:
 - i) A loan for purchase or improvement secured by a single-family dwelling or a mobile home owned and occupied by the employee as his or her principal residence, and one additional loan secured by a single-family dwelling, or a mobile home, which is or will be used by the employee as a second or vacation home;

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- ii) Loans in the aggregate not exceeding \$10,000.00 for consumer purposes;
- iii) Loans secured by savings accounts maintained by the employee at the Savings and Loan; or
- iv) Loans in the aggregate not exceeding \$10,000.00 for payment of educational expenses;
- b) Accept food, refreshments and accompanying entertainment on infrequent occasions in the ordinary course of a luncheon or dinner meeting or other function where an employee is attending for business reasons;
- c) Accept unsolicited advertising or promotional materials such as pens, calendars or other items of nominal value; and
- d) Receive, from persons outside the Association, bona fide reimbursement for actual expenses for travel and related living expenses incurred in fulfilling Association business, so incurred in faction payment or reimbursement is to be made for the same expenses, and provided that any reimbursement or payment made on behalf of an employee pursuant to this section shall be made only for reasonable, non-excessive expenses.
- 3. Gifts Within the Association. Within the Association, an employee shall not solicit a contribution from another employee for a gift to an official superior, make a donation as a gift to an official superior, or accept a gift from an employee receiving less pay than himself or herself.

However, this rule does not prohibit a voluntary gift of nominal value or donation in a nominal amount for special occasions such as marriage, birthdays, illness or retirement.

C. Misuse of Information

Except in connection with their job responsibilities, an employee shall not, directly or indirectly, use, or allow the use of, official

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information obtained through or in connection with his or her employment by the Association which has not been made available to the general public.

D. Use of Association Property

Employees have an affirmative duty to protect and conserve Association property, including equipment, supplies and other property entrusted or issued to them. Employees shall not use, or allow others to use, Association property, including leased property, for other than official Association business activities.

E. Employment Conflicts

1. Outside Employment. Employees are expected to devote their time to the Association's interests during regular work hours and during additional time as may be necessary. Outside employment is discouraged, but may be allowed provided it does not compete or conflict with the Association's interests. Any outside employment must be approved in advance by the Director of Human Resources and the employee's manager.

Certain types of outside employment or business activities will not be approved under any circumstances. These include, but are not limited to, the following:

- a) Work for any company or engaging in any business activity that competes or conflicts with Association interests including Savings & Loans or real estate companies;
- b) Any outside work that involves the use of Association equipment, supplies, or facilities;
- c) Any outside work that suggests the Association sponsors or supports the employee's outside employer;
- d) Any work that involves preparation, audit, or certification of any document the Association may use to conduct its business;
- e) Employment as a real estate salesperson, broker, agent, or contractor;

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- f) Any work involving the private practice of law by any member of the legal staff; or
- g) Any outside business activity with any other Association employee.
- 2. Employment of Family Members. Members of the same family may be employed by the Association provided one family member does not manage, supervise, process, review, or audit the work of another family member. Family members may be employed only with the advance written approval of the Director of Human Resources. For purposes of this policy, a "member of the same family" or "family member" is defined as:
 - a) a spouse, child, parent, brother, sister, or dependent, whether or not living in the same household;
 - b) any household member, whether or not a relative; or
 - c) any individual who represents or acts as an agent or fiduciary for any person listed above.

F. Outside Business Activities

1. Directorships and Officer Positions. Employees who intend to serve as a director or officer of any for-profit organization other than the Association must have the written approval of the General Counsel. Approval of the Board of Directors is required for any Senior Vice President or above of the Association to serve in these capacities. Normally, approval will be granted if no conflict of interest exists between the organizations. The approval may be revoked if a conflict of interest later is determined to have developed.

Employees serving as a director or officer of any NON-profit organization must notify the General Counsel, in writing, if a conflict of interest exists between the organization and the Association. Upon review, employees may be asked to remove themselves from their position with the outside organization if a conflict exists.

2. <u>Fiduciary Appointments</u>. An employee may act as an executor, trustee or guardian, or in any other

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fiduciary capacity in circumstances involving members of the employee's family or the family of the employee's spouse (See definition of family member in Section III.E.2. above). All other situations in which an employee is to act as a fiduciary require the approval of the General Counsel.

G. Political Activities. The Association encourages employees to maintain active interest and participation in the political and governmental process; however, employees shall not hold themselves out to represent the Association in political matters. Employees who desire to run for an elective political office or accept an appointment to a federal, state or local government office should discuss their plans in advance with the General Counsel to ensure the absence of conflicts with the business of the Association.

EMPLOYEE RESPONSIBILITIES

The Association is committed to the enforcement of the Business Conduct Policy; and all employees are entrusted

with the responsibility of knowing and following the rules and standards contained within it, including obtaining required approvals when necessary. Failure to follow the policy may result in disciplinary action up to and including termination of employment with the Association.

Any employee who has a question about these policies or any conduct or financial activity he or she has undertaken or plans to undertake may discuss the matter in confidence with the Director of Human Resources or General Counsel.

Upon hire, and annually thereafter, employees will be asked to sign a form acknowledging that they have read and understand this Business Conduct Policy. All officers and professional level staff will be required to complete a Disclosure Statement upon hire and annually thereafter. These statements will be retained in a confidential file by the Director of Human Resources. To insure the confidentiality of this information, access shall be limited to the Director of Human Resources, the General Counsel, the Chief Executive Officer, and the Chairman of the Board.

In addition, all employees shall be responsible for reporting any failures by other Association employees to

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follow this policy and for reporting any suspected fraudulent activity. Any discussion of the behavior of other employees will be treated as strictly confidential. It is the Association's policy that no reprisal may be taken against any employee who provides information about possible violations of this policy.

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GUIDELINES FOR INTERESTED-DIRECTOR TRANSACTIONS

I. INTRODUCTION

In order to ensure that all transactions in which the Association engages are fair to, and in the best interests of, the Association, the Board of Directors of the Association ("Board") hereby establishes and imposes the following rules and procedural requirements to safeguard the interests of the Association when one of its directors is affiliated with a company ("affiliated company") seeking to do business with the Association. The Board expects that such transactions will occur infrequently; however, when such occasions do arise, interested directors and the Board as a whole are required to adhere strictly to these rules.

II. REQUIRED PROCEDURES

A. Disclosure Prior to Inception of Transaction.

If a director has any material beneficial interest in any company seeking to engage in a business transaction with the Association ("interested-director transaction"), including, but not limited to, transactions by which an affiliated company would provide services of any kind to the Association and transactions by which such company would enter into a purchase-and-sale agreement with the Association, such director must fully disclose the nature of his or her interest to the Board of Directors at the inception of such transaction. Full disclosure shall include the nature and extent of any personal, financial, or fiduciary interest; and such director shall provide any information, and in such detail, as the Board may reasonably request regarding such interest and such transaction.

The Board must approve any interested-director transaction before the Association executes any agreements with an affiliated company or completes any process by which the Association becomes obligated to such company. Before the Board may consider or vote to approve an interested-director transaction, the following requirements must be satisfied:

l. <u>Internal Report</u>. The employee of the Association most directly responsible for entering into the interested-director transaction must prepare a memorandum for

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submission to the Board detailing the procedures followed in choosing to do business with the affiliated company, and certifying that such procedures, and the terms of any contracts proposed, are essentially the same as those which the employee employs in the ordinary course of business. Such memorandum shall include (a) where applicable to the transaction involved, a comparative assessment of the affiliated company's qualifications, (b) a record of other companies from whom the employee selected the affiliated company and the bids or offers submitted by such other companies, and (c) specific reasons why the affiliated company was chosen.

- 2. <u>Special Contractual Termination Right</u>. Those contracts which are proposed to the Board pursuant to interested-director transactions must contain a special termination right giving the Association the right, unilaterally and in its sole discretion, to terminate the contract upon written notice to the affiliated company, if, in the opinion of the Association, a conflict or potential conflict has arisen.
- 3. <u>Approval of General Counsel</u>. The approval of the transaction by the Association's General Counsel must be obtained after the two preceding requirements have been fulfilled, and before the matter is submitted to the Board.
- 4. <u>Mutual Disqualification</u>. An interested director shall agree, at the time of first making disclosure to the Board, that he or she shall be disqualified from taking any actions in any way related to the Board's consideration of the transaction or company in which the director has an interest, and that such disqualification shall prohibit the director from voting on or attending those portions of Board meetings at which such transaction or company is discussed. In addition, such director shall agree that he or she shall not participate in any activities in the affiliated company which relate to any agreement or transaction between such company and the Association.

Upon completion of the foregoing requirements, the Board may consider and vote upon the interested-director transaction. The Board must approve such transactions by adopting a resolution approved by at least a majority of the entire Board, with no director having an interest in the transaction voting. The approval of the Board shall be expressly conditioned upon the approval of FSLIC, as discussed below.

ADMINISTRATIVE OFFICES: One Market Plaza Spear St. Tower, 38th Floor San Francisco, CA 94105 (415) 543-3232 FAX: (415) 777-0669

C. FSLIC Approval.

Pursuant to Section 14 of Article III of the Association's Bylaws, the approval of PSLIC shall be obtained prior to the execution of any agreement for or the obligation of the Association to any transaction in which a director has an interest.

III. LITIGATION

A. Disclosure.

If a director is affiliated with a company or other entity which is involved in, has been involved in, or has a substantial likelihood of becoming involved in any litigation or dispute with the Association, such director must fully disclose to the Board the nature and circumstances surrounding such litigation or dispute at its inception or as soon as possible thereafter. The interested director shall provide any information, and in such detail, as the Board may reasonably request regarding such dispute or litigation.

B. Actions by Board of Directors.

Following disclosure of the dispute or litigation, the Board shall determine by a majority vote, with no director having an interest in the dispute participating or voting, whether the interested director's involvement in the dispute is such that the director faces an impermissible conflict of interest. If the Board determines that such a conflict exists, it shall ask for the interested director's resignation.

In the event that the interested director refuses to remove himself or herself from the Board after the Board has made the foregoing determination, the Board immediately shall notify the FHLBB and shall recommend that the FHLBB remove the interested director for "good cause", in accordance with Article III, Section 13 of the Association's bylaws.

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20515-6051

February 13, 1987

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GEORGE C. WORTLEY, REV YOR
GAND ORBERT, REM YOR
DAND GREEK CALIFORNA
MARGE ROUTERA. HEW ASSET
DOUG BEREUTER MERASIKA
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Honorable L. Linton Bosman, III Commissioner Texas Savings and Loan Department 2601 N. Lamar Blvd., Suite 201 Austin, TK 78705

Dear Mr. Commissioner:

Reference is made to Committee staff discussions with you concerning the desire of the Subcommittee to continue hearings on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. These hearings will resume on March 3, 1987, at 10:00 a.m. in Room 2128 Rayburn House Office Building, in accordance with the schedule of witnesses contained in the enclosed Subcommittee notice of February 12.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. It is my understanding that you have discussed some of the provisions of said bill with the author. Any other suggestions that you may care to submit will, of course, be appreciated as we endeavor to provide assistance to FSLIC and hence assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

Your comments on federal procedures and their relationship to state law, particularly in the area of change of control matters, would be of interest. While there seems to be an emerging consensus on the basic facts involved, still there is a wide difference of opinion as to how the situation has developed, and, of course, beyond the immediate need for stability, we are always interested in considering long-term goals and objectives due to the importance of the subject matter.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing records and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

Sincerely,

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FJStG:bSH Enclosures FRANK AMBUREDO, RUNDOS
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DOUG BANNARIO, M. GEORGIA
JOHN J. LUANZE, MWY VORK
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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
MINETY-HINTH CONGRESS
ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6051

February 13, 1987

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Mr. Walter McAllister, III Chairman of the Board and CEO San Antonio Savings Association P. O. Box 1810 San Antonio, TX 78296

Dear Mr. McAllister:

Reference is made to Committee staff discussions with you concerning the desire of the Subcommittee to continue hearings on the provisions of the Federal Savings and Loan Insurance Comporation Recapitalization bill, H.R. 27, and related issues. These hearings will resume on March 3, 1987, at 10:00 a.m. in Room 2128 Rayburn House Office Building, in accordance with the schedule of witnesses contained in the enclosed Subcommittee notice of February 12.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. It is my understanding that you have discussed some of the provisions of said bill with the author. Any other suggestions that you may care to submit will of course be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

Sincerely,

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS INSETY-METH COMMISS.

ROOM B-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20618-8061

February 13, 1987

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Mr. Roy G. Green, President Pederal Size Loan Bank of Dallas P. O. Box 619026 Dallas/Ft. North, TX 75261-9026

Dear Mr. Green:

Reference is made to our respective staffs' discussione concerning the desire of the Subcommittee to continue hearings on the provisions of the Pederal Savings and Loen Insurance Corporation Recapitalization bill, H.R. 27, and related issues. These hearings will resume on Harch 3, 1987, at 10:00 a.m. in Room 2128 Rayburn House Office Building, in accordance with the schedule of witnesses contained in the enclosed Subcommittee notice of February 12.

In addition to your comments on the provisions of H.R. 27 and the feasibility of shorter-term approaches to the recapitalization problem, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. I believe that you are familiar with those provisions and have made statements concerning their practicality from a regulatory agency perspective. We believe those comments should be formalized so that the Subcommittee can reach a decision on the appropriateness of a number of forebearance proposals.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which the Federal Home Loan Bank has discharged its responsibilities concerning a number of associations within the bank's jurisdiction. More particularly, the frequent charge of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made.

While we recognize the difficulty in responding to charges which are not identified by institution, nevertheless we would appreciate your making every effort to inform the Committee of the procedures followed to ensure that institutions and individuals are treated fairly and that reasonable doubts are, in fact, resolved in the favor of those institutions which experience serious difficulty. In those instances of voluntary waivers of administrative hearings, otherwise provided for by law and/or regulation, we would appreciate a summary of those instances and a discussion of the criteria used for insisting upon such "voluntary" weivers.

We have also received information tending to support charges that change of control procedures have been inadequately developed and poorly implemented and, as such, are a contributing factor in the fact that somewhat less than desirable individuals may have gained control of financial institutions in your jurisdiction, in certain instances contributing significantly to subsequent difficulties experienced by the institution.

Your comments in this area will, of course, be appreciated in reviewing the adequacy of existing laws in an effort to promote long-term stability of the industry once we have confronted the immediate task at hand—the preservation of FSLIC and the short-term stability of those institutions insured by FSLIC.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing records and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

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COMMITTEE ON BANKING, RMANCE AND URBAN AFFAIRS INSETHMENT COMMISS.
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20818-0061

Pebruary 13, 1987



. H. Joe Selby, Director pulatory Affairs Supervisory Agent leval Home Loan Bank of Dallas O. Box 619026 Llam/Ft. Worth, TX 75261-9026

ur Mr. Selby:

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

INVETY-WITH CONSTESS
ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-8051

February 24, 1987

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Mr. Frederick D. Wolf, Director Accounting and Financial Management Division General Accounting Office 441 G Street, N.W. Washington, DC 20548

Dear Mr. Wolf:

This is to confirm staff notification today as to the change in the hearing schedule. $\label{eq:change} % \begin{array}{c} \left(\frac{1}{2} -$

It would be appreciated if you will appear on the second panel on March 3 rather than on March 4, as originally scheduled.

Sincerely,

Richard L. Still Staff Director

RLS:bh

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON. DC 20515-8051

February 13, 1987

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Mr. Frederick D. Wolf, Director Accounting and Financial Management Division General Accounting Office 441 G Street, N.W. Washington, DC 20548

Dear Mr. Wolf:

Reference is made to our respective staff discussions concerning the desire of the Subcommittee to continue hearing; on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. These hearings will resume on March 3, 1987, at 10:00 a.m. in Room 2128 Rayburn House Office Building, in accordance with the schedule of witnesses contained in the enclosed Subcommittee notice of February 12. As you will note, your appearance is scheduled for March 4.

We are, of course, aware of the ongoing efforts of the General Accounting Office in monitoring the operations of FSLIC and the thrift industry. The briefing you provided to this Committee's staff was most helpful in this regard. Many of GAO's studies have been in response to requests of this Committee and individual members of the Committee, a clear indication of our longstanding concern. A summary of those efforts has been provided by GAO and that summary of course will be made part of the printed record of the hearings.

From the perspective of GAO we would appreciate your comments on the provisions of H.R. 27 and a discussion of a shorter-term approach as has been proposed by a number of individuals and organizations. In addition, there has been considerable comment concerning forebearance possibilities, and, in that connection, a copy of H.R. 1063 is enclosed. Your comments would be appreciated concerning these provisions with particular emphasis upon the applicability or feasibility of FASB-15 as an assist to the current problems confronting the Corporation and a number of distressed institutions. We understand that your own background in the private sector will be especially useful in dealing with this subject as well as your intimate knowledge of the oil and gas industry, which has, as I am sure you know, been cited as one of the reasons behind the difficulties being encountered by Texas institutions and out-of-state institutions who are involved in participation relationships.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn Bouse Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing records and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

Sincerely,

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U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS MINETY-MINT CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20615-8051

February 24, 1987

CHALMES P WPILE, (HID Jan Jack), AND HID PTRINST B. HILTERSTY, COMISSION HILLIAMS B. BORMMAY, CALEBON BU, MEDDAJAH, FLORIS BAND BRIDGE, CALEBON BAND BRIDGE, CALEBON STAIN FAMILY, WIREN MARIE TOWNSA, HUMBER BOUR BORNTY, WIRENA STREET BASTLETT, WIRENA STREET BASTLETT, WIRENA

Mr. Donald E. Kelly Assistant Legislative Counsel Society of Real Estate Appraisers 600 New Hampshire Avenue, N.W. Suite 1111 Washington, DC 20037

Dear Mr. Kelly:

This is to confirm my discussion with your Washington office and Bob Morin in Tucson concerning the hearing change.

Sincerely,

Richard L. Still Staff Director

RLS:bh

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS INSETY-MINTH CONCRESS
ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20615-8061

Pebruary 13, 1987

CHI LACOT PRIMA SERSIMANY COMMECTICATI NOTICE IN TOMOSTICATI NOTICE IN THE SERVICE (copy to Dr. Un Kinnerd)

Mr. David N. Peterson Society of Real Estate Appraisers 645 North Michigan Avenue Chicago, IL 60611-9885

Dear Mr. Peterson:

Reference is made to discussions between Committee staff and Mr. Don Kelly concerning the desire of the Subcommittee to continue hearings on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. These hearings will resume on March 3, 1987, at 10:00 a.m. in Room 2128 Rayburn Bouse Office Building, in accordance with the schedule of witnesses contained in the enclosed Subcommittee notice of February 12. Your appearance is scheduled for March 4, 1987.

On January 21 and 22, hearings were held by the Pull Committee on the Recapitalization proposal. Subsequent to those hearings, informal meetings were held dealing with market considerations with major underwriting firms responding to member and staff questions. Those meetings were followed by a meeting on the general subject of forebearance. During the course of that meeting with a presentation by technicians of the Bank Board, it became clear that a deeper understanding of appraisal terminology would be of assistance in evaluating various proposals and actions by government officials charged with the responsibility of supervising financial institutions.

Accordingly, the Subcommittee would appreciate receiving your testimony related as specifically as possible to pending FSLIC Recapitalization proposals and proposed amendments thereto. In particular, the applicability of FASB-15 as set forth in the material related to H.R. 1063 would be invaluable.

Enclosed are a copy of H.R. 27 (the FSLIC Recapitalization bill), a copy of H.R. 1063, and a section-by-section summary.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office

Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing records and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

Sincerely,

Fernand J. St Germain

FJStG:bSh Enclosures

cc: Dr. William N. Kinnard

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
INNETY-MITTH CONGRESS
WASHINGTON, DC 20515

February 25, 1987

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Mr. John Corzine
Partner, Goldman-Sachs & Co.
85 Broad Street, 77th Floor
New York, NY 1,0004
Dear Mr. Corzine:

Concerning our discussions, I am delighted that you will be able to testify as requested. We have changed the date of your appearance to March 3. You will appear on the second panel with the Director Frederick D. Wolf of the Accounting and Financial Management Division of the General Accounting Office and David N. Peterson, President of the Society of Real Estate Appraisers.

I estimate that the second panel will commence testimony around 12:00 or 12:30, continuing until probably 3:30 or 4:00.

I assume you saw the enclosed <u>Wall Street Journal</u> article. I thought you might like to have a summary of GAO reports issued during the past several years.

Sincerely,

Richard L. Still Staff Director

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Enclosures

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20515-6051 February 13, 1987 CHALMERS P HYTHE OWN STEVART S MCKINNEY CONNECTION STEVART S MCKINNEY CALIFORNIA BLL MCCOLLIN JORGA GONGE C MCCITLLY RIPLY YORK DAND OWEST, CALIFORNIA STAN ARREST WISHINA MANGE ROULEMA, NEW JERSEY SOUG SERVICES MISSIAN STEVE ARTHET TRANS TORY MOTH WISCOMEN

Mr: John Corzine Partner, Goldman-Sachs & Co. 85 Broad Street, 27th Floor New York, NY 10004

Dear Mr. Corzine:

A number of Committee members who attended the briefing session on January 28 have commented on how helpful it was in their understanding of marketing considerations relating to bond sales. We appreciate your having taken the time to assist the Members and staff, who were able to attend, in obtaining a better understanding of issues related to current Recapitalization of FSLIC proposals.

Inasmuch as some of these questions still remain in the minds of many Members, both on the Committee and in the House, I have determined that the Subcommittee should have an opportunity to receive testimony relating to marketing considerations. You will note from the enclosed schedule of witnesses that underwriting testimony has been set for March 4 and I hope that your schedule will permit your participation.

I believe that you are familiar with the provisions of H.R. 27, a copy of which is enclosed. I have also enclosed a copy of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee, which contains a number of suggestions that will be thoroughly reviewed by the Committee during the upcoming hearings. We primarily would expect with your backgrounds in mind that you discuss those proposals again from the point of view from a bond marketer.

In accordance with Committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing records and, if delivered when requested, the statement will be made available to all Subcommittee members in advance of the hearing. To provide all members with sufficient time for questioning, the oral presentation of your prepared statement must be limited to 10 minutes.

Sincerely,

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-MINTH CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6051

February 25, 1987

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Ms. Roslyn Payne
President and Chief Executive Officer
Federal Asset Disposition Association
One Market Plaza
Spear Street Tower
38th Floor
San Francisco, CA 94105

Dear Ms. Payne:

As per staff discussions and at the specific request of Congressman Carper, the Subcommittee would appreciate your appearance as a member of the second panel on March 3 concerning the operations of the Pederal Asset Disposition Association, during our ongoing hearings relating to the recapitalization of the Pederal Savings and Loan Insurance Corporation.

For your information, I have enclosed a copy of H.R. 27, the recapitalization bill, H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee, as well as material furnished by the U.S. League relating to that association's modified recapitalization proposal.

We appreciate the time you were able to spend some time ago to brief interested staff on FADA but believe it to be essential that the members of the Subcommittee have an opportunity to question you concerning current operations, and most importantly, to analyze projected returns to FSLIC in view of the current situation.

In accordance with committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn Bouse Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record, and, if delivered when requested, the statement will be made available to all subcommittee members in advance of the hearing. To provide all members with sufficient time for guestioning, the oral

presentation of your prepared statement must be limited to ten minutes.

Sincerely,

rnand J. St Germain

Chairman

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Enclosures

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
INNETY-HINTH CONGRESS
WASHINGTON, DC 20515

February 26, 1987

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Dr. Lionel J. Nowotny President Watson and Taylor Realty Co. 4015 Beltline Road Ballas, TX 75244

Dear Dr. Nowotny:

As per staff discussion concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues, the Subcommittee would appreciate your appearance on March 3, 1987, as a part of the second panel in Room 2128 Rayburn House Office Building.

Please find enclosed copies of H.R. 27, the recapitalization bill, H.R. 1063, the forbearance proposal introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. I have also included some material furnished by the U.S. League of Savings Institutions relating to a modified recapitalization proposal. My purpose in furnishing you this material is so that you will be generally familiar with the issues now pending before the Committee, and, of course, should you desire to comment specifically on any of the pending legislative proposals, your views will be most appreciated.

Your experience, however, as a borrower/major developer will be of particular interest to the Committee. You are undoubtedly aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's jurisdiction. More particularly, frequent charges of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as a developer and as a borrower, we would appreciate a summary of your experiences in dealing with FSLIC and the Federal Asset Disposition Association, and, of paramount importance, recommendations that you might care to

make concerning steps that should be taken to promote the stability and the recovery of the savings and loan industry, particularly in those areas experiencing severe economic decline.

In view of the short time before the hearing, we will waive the requirement for advance copies of your testimony. However, if you could make copies available to the Subcommittee the first thing on the morning of the 3rd, we will endeavor to make sufficient copies so that the members may have your statement before them when you testify. Due to the large number of witnesses, we request that your oral summary statement be preferably five minutes in length but not to exceed ten minutes to permit all members sufficient time for questioning.

Sincerely,

Fernand J. St Germain

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Enclosures

THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION RECAPITALIZATION ACT OF 1987

WEDNESDAY, MARCH 4, 1987

House of Representatives, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Committee on Banking, Finance and Urban Affairs,

Washington, DC.

The subcommittee met at 10:30 a.m. in room 2128 of the Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of

the subcommittee) presiding.

Present: Chairman St Germain, Representatives Hubbard, Barnard, LaFalce, Vento, Roemer, Neal, Carper, Kleczka, McMillen, Kennedy, Wylie, Leach, McKinney, McCollum, Wortley, Parris, Bereuter, Bartlett, Roth, Hiler, McCandless, McMillan and Saxton.

Chairman St Germain. (presiding) The subcommittee will come

to order.

Today we will receive testimony from representatives of savings and loan associations in States that have suffered economic setbacks in recent months. This testimony will give the committee some firsthand case histories of the conditions of the industry as well as an understanding of the interaction between S&Ls and their regulators.

We have a large group before us representing savings and loans in Kansas, Louisiana, Texas, Iowa, and Missouri. We appreciate your appearance here today. I am certain that your testimony will assist the committee as it attempts to work through the issues in-

volved in the proposed recapitalization legislation.

Since we do have a rather impressive panel, I am just going to follow the order as it appears on the notice of the subcommittee

hearing. I assume the staff threw all the names in the hat.

So the winner in first place—the first shall be last, and the last shall be first—is Mr. Wade Nowlin, Chairman and Chief Executive Officer of Nowlin Savings & Nowlin Mortgage Company in Ft. Worth, Texas.

He is accompanied by Mr. H. Robert Frenzel, who is President of

that organization.

Mr. Nowlin, we will put your entire statement in the record, and you may proceed.

(475)

STATEMENT OF WADE T. NOWLIN, CHAIRMAN AND CHIEF EXEC-UTIVE OFFICER, NOWLIN SAVINGS & NOWLIN MORTGAGE COMPANY, FT. WORTH, TX; ACCOMPANIED BY MR. H. ROBERT FRENZEL, PRESIDENT

Mr. Nowlin. Thank you, Mr. Chairman, distinguished Members of the committee.

We are very pleased to be here today and appreciate the invitation to share our views before this committee on the provisions of

H.R. 27, H.R. 1063, and other related issues.

The continuing drain on the FSLIC fund is well-documented. The situation has reached the point that positive action must be taken to adequately recapitalize the fund. The regulators dealing with insolvent institutions are not able to take appropriate actions, and these delays appear to be leading to increased costs to the insurance fund and a decrease in public confidence. Recapitalization in some form must happen soon.

However, this recapitalization must be accompanied by forbearance measures and reasonable regulations that allow viable, wellmanaged institutions a means to work through their problems and to build their capital bases and therefore strengthen the FSLIC

fund rather than submit it to additional risk.

We support forbearance measures only for well-managed thrifts operating within the regulations whose troubles are the result of operating in an economically depressed region and not due to fraud, imprudent operating practices, speculative ventures, self-dealing, or excessive dividends and lifestyles.

The following forbearance measures should be made regulations

administered by the Federal Home Loan Bank Board:

First, the FASB 15 should be specifically authorized in the regulations. FASB 15 allows a problem loan to remain on a thrift's books without writedown provided the loan is restructured so that it is probable that a borrower can repay the loan under the new terms and the lender will receive cash payments totaling at least the loan value.

It should be emphasized that FASB 15 is a generally accepted accounting principle but is not a cure-all because this rule will not normally apply to loans on raw land or projects without cash flow.

normally apply to loans on raw land or projects without cash flow. In addition, provided the association's independent CPA rules that FASB 15 has been properly applied, such loans should be ex-

empted from the asset classification regulations.

Second, if a loan originated or purchased prior to January 1, 1987 is foreclosed and the real estate is taken back, any loss due to a writedown of the asset to the current fair market value should be allowed to be amortized over a period of 5 to 10 years. This would allow an association both the time to work with the real estate and give the market cycle the opportunity to evolve, bringing the asset to its maximum value.

Third, the capital forbearance policy, as outlined by Federal Home Loan Bank Board last February 26, should become regulation rather than simply policy to ensure the public confidence that savings and loans operating under such provisions will be allowed to carry out their plan.

Coupled with forbearance, certain regulations currently in effect

exacerbate the situation and should be rescinded.

For example, Section 563.17-2 of the FSLIC insurance regulations requires an R41 appraisal at the time real estate is acquired through foreclosure and further requires a writedown if the appraisal is less than book value. Instead, we believe at foreclosure that the GAAP principles should be applied, requiring a determination of the fair market value, which would involve considering numerous other factors.

In the event a writedown were required through this process, as noted previously, we support the concept of amortizing that loss

over 5 to 10 years.

Section 563.13(b) of the FSLIC insurance regs requires additional regulatory capital equal to 20 percent of the amount the real estate is valued for acquired by foreclosure. If an asset acquired through foreclosure is carried at current fair market value by an institution, there is no reason or no logic in requiring additional net worth.

An asset carried at fair market value, regardless of how it was obtained, does not carry additional risk that should require additional capital. This is a double-hit concept of writing an asset down and then requiring additional capital for the remaining current fair market value. It is unnecessary, punitive, and should be abolished.

A final concern that we have for the continued viability of the savings and loan industry is the integrity of the ownership and the management of the insured institutions. Far too many examples are on record of fraud, self dealing, insider abuse, speculative or imprudent ventures, excessive operating expenses, excessive officer and stockholder compensation, and extravagant lifestyles, and tremendous growth fueled by high interest rates and often brokered deposits.

Using due process and individual judgment at all times, the regulatory authorities must move swiftly and forcefully against this element in our business. Neither the FSLIC nor the legitimate, well-managed thrifts should be required to pay for the excesses of those

managements not willing to play by the rules.

Mr. Chairman, I again want to thank you for inviting us to present our views on these important issues. We appreciate your consideration of our point of view, and we would be glad to answer any questions you might have.

Thank you very much.

[The prepared statement of Mr. Nowlin can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Nowlin. I would thank

you for a very concise, but a very helpful statement.

During the questioning period, I intend to bring out and reemphasize some of the points you made, but your testimony is certainly appreciated because it is very helpful to us.

Our next witness is going to be Jenard Gross, Chairman and Chief Executive Officer, United Savings Association of Texas, in

Houston, TX.

We will put your entire statement in the record, and you may proceed.

STATEMENT OF JENARD M. GROSS, CHAIRMAN AND CHIEF EXECUTIVE OFFICE OF UNITED SAVINGS ASSOCIATION OF TEXAS, HOUSTON, TX

Mr. Gross. Good morning, Mr. Chairman, honorable Members of the subcommittee.

My name is Jenard Gross, Chairman of the Board and President of the United Savings Association of Texas, the largest S&L in Texas, with assets of \$6.5 billion.

I grew up in Nashville, TN and have lived my adult life in Houston, and I realize that these testimonies and hearings are old hat to you. On the other hand, I couldn't help thinking as we were coming in last night what a thrill it is to come into Washington, DC. and to see the Washington Monument, the Jefferson Monument, the Capitol Dome lit up, and the Lincoln Monument.

You know, you get really a feeling of warmth, such as you probably only get from your association with your family, when you see the great historic institutions in our country, and I couldn't help but think of the TV program, Amerika, which was on a few weeks ago, and as I sit here this morning a little bit nervous, while I am here to try to offer suggestions about our industry's need for survival and the problems in our State, you still have to stop and think that this is the only place in the world where we could come to address our problems in a free manner without fear of reprisal, and it sort of feels one with awe just to think about it.

Getting back, I guess, to what I am really here for, I can appreciate it is hard for you to understand the problems of the Oil Patch because the East Coast is extremely prosperous today, the West Coast is extremely prosperous, Nashville, where I grew up, is having the boom of all time—we can't believe what is going on down there—yet in the Southwestern part of the United States we are suffering from a depression, the likes of which has not been

seen in the last 50 years.

Oil has dropped from \$40 to the current \$16 a barrel in the last 5 years. Corn, soybeans, cotton, wheat are all less than half the price

they were a few years ago.

Unemployment in Houston is over 10 percent; whereas, 5 years ago it was the lowest of any major city in the country. Oil field equipment manufacturing employment is off some 80 percent in the Houston area.

Houston home foreclosures were 16,000 in 1984. There were 25,000 in 1986 and 3000 in January of this year. United alone has

been foreclosing houses at the rate of over 100 a month.

I did a check to see the age of these houses recently. In the month of July, 35 percent of the houses that we foreclosed were loans that were made back in the 1970s. They weren't loans that were made in the last 2 or 3 years.

Our real estate values in Houston are off some 38 percent over

the last 3 or 4 years.

I had a situation the other day where a lady walked into one of our offices. She was nicely dressed. She got out of the car. She came in. She walked up to someone in our office and said:

Here are the keys to my house. My husband lost his job here about 4 months ago. We have been trying to sell it unsuccessful.

My husband got a job in Birmingham a couple of weeks ago. The loan is current. The house is clean. Here are the keys. I am sorry.

Goodbye.

And we went out. Of course, the house was in perfect shape. The loan was current, and we will probably incur a significant loss in selling that house because it is worth less today than it was at the time it was built.

We have got situations where we have got subdivisions, where we

have hundred thousand dollar houses that were built-

Chairman St Germain. Let me ask you something. Those people owe you the difference between what you sell the house for and that which they owe, correct? Mr. Gross. Yes.

Chairman St Germain. I am just curious here. Would you then

pursue that course of action?

Mr. Gross. It is hard to pursue that course of action. In most cases it is an example—let's say that these people had moved to Birmingham, AL. You have got to try to pursue the cause of action

in Birmingham. You have got to establish the value.

We do now, because of the mortgage insurance companies, try to establish a loss value, but the chances of recovery are extremely remote. I would say, having served on a bank board in years gone by, I can see a situation where when people want to clear their credit up in years to come they might come back and start making payments to recover a loan, but they might be 5 and 10 years later.

It is not a matter of our losing \$15,000 on a house and somebody saying, well, here is a check for it. It becomes a very extended situ-

ation.

What we are faced with at this point is a situation where we have got \$100,000 houses that get sold for \$70,000. Then when the appraisers go out and find the \$70,000 house, now all the houses in that subdivision based on those recent sales are now \$70,000 houses. If someone else in that subdivision tries to sell his house for 80, he can't get a loan because by regulation we can only lend 90 percent of that appraised value.

So that has now established a new level of price in that subdivision. It is a \$70,000 value. If it breaks to 65, then the same appraisal process goes through. So the very appraisal helps drive down the

potential for recovery in that subdivision.

What we basically need at this point in time is time to work out our problems. Real estate is not an item which is a liquid asset which is priced on a day-to-day basis. It is a long-term asset. Just as real estate is depressed in the Southwest today, it was depressed in Boston 10 or 15 years ago. It was depressed in New York 10 years ago. It was depressed in Detroit 5 years ago.

Those markets have all recovered, and we, too, will recover. Oil will come back, agriculture will come back, the word will get good

again, people will flow into Houston and Texas again.

The main thing we need is a timeframe in which to have an opportunity to let these real estate assets recover their value.

The items which were outlined by the previous speaker are very

similar to the items that we would endorse.

We certainly endorse FSLIC recapitalization. We feel the need for a period of time to spread out these losses that we are taking.

He suggested 10 years. I know that farm banks are using a 20-year span, which I would find more beneficial.

But we need legislative assistance as opposed to regulatory because the legislative will carve it in granite, whereas the other is subject to frequent change. We feel that a good institution needs the same forbearance as a bad institution. The mere fact that we have more than 3 percent net worth doesn't mean that we should become a sick institution by continually writing down and eroding our assets.

On the other hand, it accomplishes nothing to bail out the institution with a half percent net worth and bring us down to where we then have a half percent net worth.

So just as the healthy banks don't write down the LDC loans, we don't think that the healthy S&Ls should write down the losses in real estate instantaneously and make themselves sick.

We think that the appraisal process needs to be changed. We feel it is much too stringent. We looked at an appraisal the other day. The same appraiser looked at an apartment project in 1981 and said rents were going to go up 10 percent a year, and he based his appraisal on that, and they didn't go up. His new appraisal is about 60 percent of his original appraisal, and now he says rents are going to be flat for the next 3 years.

Chairman St Germain. Is that the same appraiser?

Mr. Gross. Yes, sir.

Chairman ST GERMAIN. Did he reimburse you for that initial reappraisal? [Laughter.]

Mr. Gross. We would love to file suit, but we haven't gotten up the nerve to yet. And this is the type of thing that we run into.

The appraisers today—we looked at one, and he is using a 14.5 percent return on equity, and nobody is getting 14.5 percent return on real estate equity. He is using 11.5 percent return on debt. Today you can create debt on real estate and 9.5 and 10 percent. So his figures come out unrealistically low, and then our auditors come in and say his appraisal isn't good enough; it is not stringent enough and it should even be worse than that.

Basically, we need some help on our net worth to get us through this period of time. We need the appraisal situation examined again. We need the moratorium, the forbearance and, given 10 years, we'll all look back on this and say: This was a great dying opportunity in Houston and the Southwest. But, in the meantime, we've got to get from here to there and remain healthy and viable, and we hope you will enable us to do that.

[The prepared statement of Mr. Gross can be found in the appendix.]

Chairman St GERMAIN. Thank you, Mr. Gross.

Now, we'll hear from Mr. W. Drew Darby, who is an attorney for a group of West Texas lenders; accompanied by Thomas Sullivan, Jr., who is Chairman of the Board of Tristar Capital Corp., of Dallas, TX.

Mr. Darby, we'll put your entire statement in the record. You may proceed.

STATEMENT OF W. DREW DARBY, DALLAS, TX, ATTORNEY, WEST TEXAS LENDERS; ACCOMPANIED BY THOMAS J. SULLIVAN, JR., CHAIRMAN OF THE BOARD, TRISTAR CAPITAL CORP., DALLAS, TX

Mr. DARBY. Thank you, Mr. Chairman. My name is Drew Darby. I'm a practicing attorney with offices in San Angelo and Dallas, TX. Because one of my offices is located in the heart of an oil patch and the other office is located in the combat zone, which is commonly known as Dallas, my clients and I have been in the trenches trying to survive these extraordinary times.

I'm painfully aware that FSLIC must be recapitalized, and House Bill 27 provides the mechanics for accomplishing this necessary

goal.

However, coupled with said recapitalization, there must be a framework established which will permit necessary and reasonable regulatory control to co-exist with sound, well-managed thrift institutions.

I am convinced that the thrift forbearance and supervisory format being offered as an addition to H.R. 27 is a major step in

the right direction.

But, even this farsighted piece of legislation has not gone far enough in several areas. Section 22(A) allows the board to establish its own review and appeal procedure, including the appointment by the PSA of a panel of independent operators.

I submit to you that this provision is deadly similar to letting Dr. Jekyll appoint Mr. Hyde. In our jurisprudence system, you do not

let the accused select his own jury.

One of the major complaints which my clients have of the present regulatory system is that they are frustrated by the lack of a single, individual group which they can report to and from which they can expect a reasonable and timely answer to their problems.

Second, they feel that the system is ruled through intimidation and affords them no real venue for appeal or review of the deci-

sions which have robbed them of all normal due process.

Chairman ST GERMAIN. Mr. Darby, that type of statement really scares me. When I hear a statement like that, I become frightened

because the regulator is not supposed to use intimidation.

Now, you have made the statement. Now I ask you, as the old adage goes in New England, "Put your money up there where your mouth is." Tell us. Tell me about the intimidation. When did it occur? By whom? And against whom?

Mr. Darby. Mr. Chairman, it's in my prepared text.

Chairman St GERMAIN. Tell me about it now.

Mr. Darby. One such institution asked me to appear before the Federal Home Loan Bank in Dallas. They had been notified of the precarious financial position, so they asked that I accompany them to the Dallas Board.

Chairman ST GERMAIN. Which institution was that?

Mr. DARBY. The San Angelo Savings Association.

We retained a Washington attorney to help us with that process. Chairman ST GERMAIN. Are you at liberty to tell us who that attorney is or was?

Mr. Darby. I believe her name is Ms. Jones, with a law firm here in Washington.

Chairman St GERMAIN. Which firm?

Mr. Darby. I don't recall at this time. We appeared before the principal supervisory agent.

Chairman ST GERMAIN. Who was?

Mr. Darby. William Churchill. And we proceeded with opening statements. We presented our plan for the institution's recapitalization and the Washington attorney was interrupted by the supervisory agent with the comment that, as he slammed his glasses down, he really didn't care what the institution's plans were, that he had his own designs for the institution. And this is what we were going to do.

And I was accompanied by the board of directors of the institution, none of whom had ownership in the institution. And they were afraid, frightened and frustrated because they knew that the judge and the jury and the Supreme Court had just rendered a final and nonappealable verdict. And that frustrated them, Mr.

Chairman.

Chairman St Germain. We will discuss that a little further in the question and answer period. You may proceed with your statement.

Mr. Darby. About a year ago, countless teams of Federal auditors descended across the mid-west to ascertain the financial condition of all the thrift institutions. Because of the size and extent of the perceived problem, these teams were largely composed of young and inexperienced people, who were, for the most part, not from that region to which they were assigned.

Right or wrong, the Texas thrift industry believes that the examiners' marching orders were to ride into town, shoot the bad guys, depress values and hold the bank up until the town's people would

allow out of State banking.

That is precisely what has happened, Mr. Chairman, although I have no complaints about the expulsion of any outlaws from the

However, monstrous decisions were made which resulted in the immediate reclassification of loans, which in turn created many in-

solvent institutions.

Referring to the meeting that we had with the supervisory agent, we believe that there was no due process or guidance in that hearing, only the booming voice of a regulatory official that had no reviewing authority.

Indeed, a Dallas U.S. District Judge only last Thursday ruled that the courts may only judge whether or not the Bank Board employed arbitrary and capricious standards in closing out a thrift.

Absent statutory constraints, the regulators answer to no one, including the courts, in determining the life or death of these institutions. The impact is that you'd better go along with the regulators,

regardless of the consequences.

Even though that meeting between the institution and the PSA took place nearly 9 months ago, the institution has not to this day received their final audit report. The institution's board of directors are operating in a vacuum, not knowing which direction the regulatory winds may blow.

They are afraid to stay on the board for the fear of being sued if the institution is closed. On the other hand, they're afraid to resign because of the fear that the PSA will replace them with a less interested board, whose decisions will exacerbate the situation, thereby creating more losses, which may also result in a lawsuit against the former board.

Even though a State Banking Commission representative is present at all meetings, no final decisions can be made on the sale of institution property or workouts on existing loans without Bank

Board approval.

For example, this particular institution has property that it is trying to sell and has, in fact, received an offer for a cash sale which was at least three times the institution's cost in that project.

The board of directors and the State supervisory representative wanted to sell the property but were afraid to do so without Federal approval, because of the fear that they were not selling the property for enough money.

The request for sale remained unanswered for months while the institution lost a golden opportunity to improve its financial condi-

tion.

One of the questions that I have is:

Where there is evidence of sound management in the institution, why transfer the crucial decision-making process from a group who is intimately familiar with a project to a typically inexperienced,

overworked and largely disinterested individual?

This type of supervision simply does not work. A capital forbearance policy must be established which permits the institutions which have a weakened capital position as a result of a general economic decline to control the decision-making process in those matters which substantially affect them, their community and their property rights.

In addition, the review board which is to be established under 22-

A is a necessary and vital ingredient for any hope of due process in

this system.

When considering this particular provision, please keep in mind

the following.

One, the composition of the panel. For example, nonrelated thrift industry personnel, supervisory agents and perhaps congressional representatives from the House Select Committee for that District to the independence of the panel.

For example, the panel could be appointed by Congress to each

Federal Home Loan Bank district.

And, three, the finality of their decision. For example, the Federal Home Loan Bank president is urged except in extreme circumstances to take the recommendation of the panel.

Ladies and gentlemen, while most of what you have heard in the last several days has been fairly dismal, I'm also here to report to

you that the situation has improved.

I recently had one thrift officer report to me that 6 months ago, 90 percent of all requested workouts were denied. Today, that

figure is 90 percent of all requested workouts are approved.

As long as the Congress of the United States controls the purse strings and those strings demand fair play, due process and accountability, then there is hope for recovery of the thrift industry.

My statement has been written from the perspective of a lawyer on behalf of his victimized client. Because of recent events, my per-

spective has changed to that of the victim.

After receiving an invitation to appear before you, I was notified that a team of Bank Board investigators had been sent to one of my lenders to examine my personal and business relationship with them.

Is this only coincidence? Are these actions an example of proper

regulatory control? Is this Orwell's Big Brother mentality?

Chairman St Germain is correct when he states that we must ensure and preserve regulatory independence, but at what price?

Do we sacrifice the right of free speech or that of due process? The primary issue for you folks today is the supervisory process itself and how it deals with these institutions. You must make it more sensitive and responsive to the needs of the industry.

It must be held to some level of accountability for its actions by

the Congress or the courts.

This concludes my prepared statement. I welcome any questions. [The prepared statement of Mr. Darby can be found in the appendix.]

Chairman St GERMAIN. Thank you.

Mr. Sullivan, I understand you as well have a statement. Have you submitted one for the record? All right, we'll recognize you at this time.

STATEMENT OF THOMAS J. SULLIVAN, JR., CHAIRMAN OF THE BOARD, TRISTAR CAPITAL CORP., DALLAS, TX

Mr. Sullivan. Mr. Chairman, Members of the Subcommittee, my name is Thomas Sullivan. I presently reside in Dallas, TX and I am President of a real estate development and mortgage brokerage firm. My financial background covers a wide area of real estate, oil and gas and lending relationships.

I have in the past 2 years been involved in the acquisition and sale of over \$100 million of real estate within the State of Texas,

predominantly in the Dallas/Fort Worth Metroplex area.

I have also worked closely with various savings and loans and commercial banks in a mortgage brokerage capacity and in marketing lender-owned repossessed properties.

The adverse economic conditions caused by the collapse of the oil

industry have been headlined throughout the country.

However, the upheavels felt in the energy-producing States may only be the beginning of a much more serious problems. That is, the impending collapse of the real estate and thrift industries in those States where the lending institutions under the heavy regulatory hand of the Federal Home Loan Bank.

I have condensed many hours discussions I've had with lenders and clients into four leading observations and suggestions for the

committee's consideration.

Number one, is thrift control to allow for real estate professionals? As in any business, the best person for the job is the person with experience and knowledge in the areas defined by the job description.

It's ludicrous to assume that a lawyer should not be permitted to be a congressman because his knowledge and ability to manuever inside the legal system would make it dangerous for him or her to

perform in a law-making and regulatory body.

I believe it's equally ludicrous to assume that a competent and knowledgeable person that makes his livelihood primarily from real estate-related activities, even as a developer, would not make an excellent person to own and operate a thrift.

In the past as well as in the present, this classification of a control owner has typically been denied approval by the Bank Board. The denial seems to be linked to the scenario of the fox in the henhouse in order to prevent self-dealing and conflicts of interest.

This denial implies that all people with their primary source of income derived from real estate would become entangled in illegal

self-dealing.

The competent real estate developer is experienced in fields of asset evaluation, marketing, construction, management and financing, which experience is indispensible as it relates to the manage-

ment of a thrift.

Second, is forbearance in foreclosures of real estate loans with achievable equities. As demonstrated in the past, some of the largest losses in loan collateral values have occurred after foreclosure. Many properties that are without hope of recovery or are in the hands of incompetent or unscrupulous owners should be foreclosed and managed by the receiving institutions or, in many cases, by FADA.

The bulk of the foreclosures, however, or those that are candidates for foreclosure are in that condition because the debtor has become unable to service the loan as agreed in the original loan document.

Presently, it is very difficult to even negotiate the renewal of a loan that is in a past due status. Because of these difficulties, posted foreclosures are amounting to over a billion dollars a month in Dallas and Tarrant Counties alone.

After foreclosure, the properties are being returned to the market at wholesale prices, which action is further pushing down

the value of real estate.

In the case of real estate, with achievable equities as demonstrated by either current appraisal or past market trends, that should reoccur with absorption and the availability of mortgage money, the existing property owners are typically the most qualified and interested people to manage and market what they have their financial reputation invested in.

I recommend that the lender's forbearance be allowed to provide for the accruing of interest on a mortgage during a specified period if the debtor demonstrates the willingness and capability to proper-

ly manage and market the asset.

I believe the ultimate cost to the savings and loans and the FSLIC funds will prove far less than adding the personnel and related overhead to manage and market these properties.

Third is a discussion on the Asset Acquisition Corp.

I believe the formation of an Asset Acquisition Corp. as a subsidiary of FADA, to be funded either by private sources or from Federal Home Loan Bank System, would provide a much 1

entity to purchase foreclosed properties. It is proposed that this entity could acquire foreclosed assets from troubled institutions, thus relieving them of the burden of holding and maintaining the assets. However, this entity could also be used as an outlet for property sales in lieu of granting forbearance to deserving owners.

The Asset Acquisition Corp. would stand to profit from the purchase of undervalued foreclosed properties in lieu of the owner and would be a formidable competitor in the marketplace. As a shield against this possibility, I believe this entity should not be allowed to purchase properties from thrifts. Only upon liquidation of the thrift should the assets be conveyed to FADA for its offering to the public.

A minimum bid price should be established by FADA for a public offering, and only upon not achieving its price should the assets be sold to the Asset Acquisition Corp. at the minimum bid value. The corporation will provide for the purchase and ultimate resale of assets, with any profits to be distributed to the corporation's investors, with perhaps a percentage to apply to the cost of the requested FSLIC funding.

Last, the creation of a healthy real estate industry. I believe that is the crux of the problem today, is the unhealthiness of the real

estate industry.

A Treasury quotation taken from the U.S. League's response to Treasury Department criticisms of the savings institution self-help program for funding the FSLIC is, and I quote:

"The only reason FSLIC has any reserves is because it has put hundreds of insolvent savings and loans with over \$100 billion of

assets on ice."

This statement by the Treasury demonstrates that available financing has, except for single family residences, been almost irradicated in troubled areas such as Texas, and this restriction of credit is precisely the reason why there is an impending financial collapse of the real estate and thrift industries in those areas where the institutions have been put on ice.

The ingredients of a healthy real estate industry are threefold.

We need product, buyers, and available financing.

Without product and with buyers and financing, the value for product will increase. Without buyers and with product and financing, the value for product will decrease. However, without financing and with all the product and buyers you need, the value for product will decrease and continue to decrease as more product becomes available due to foreclosures.

By virtue of putting on ice hundreds of savings and loans which control \$100 billion of assets, the financing available to investors to acquire real estate has been removed, which has further accelerated the demise of the thrift industry and the FSLIC insurance fund. Until the money supply is returned to the marketplace, the value of real estate will continue to tumble to the point where prices are much lower than the utility value of the product, such as one purchasing a retail corner for the economics of planting a garden.

Unless the money supply is returned to normal, the best investment possible would be short real estate in the State of Texas

along with S&L bank stocks.

To restrict or overregulate certain classifications of loans is to

remove that financing from the market.

To restrict raw land loans is to remove the first step in the resultant development of any type of end-use, including single family residences.

Areas of Texas that have been experiencing a long term steady growth in real estate values are now subject to wild, haphazard value fluctuations due to the dumping by owners and lenders who are unable to carry the burden on the supply side of real estate, without the existence of the supply side of available financing.

However, I suggest that recapitalization of FSLIC and forbearance by the regulators will not alone solve the impending collapse of the real estate and thrift industries unless it is coupled with the renewal of available mortgage money for the acquisition of all types of real estate to be controlled by the supply and demand forces of the marketplace.

Ladies and gentlemen, I close with the statement that I did not travel to Washington to testify as a wealthy individual, for I am not, or as the President of a financially strong real estate invest-

ment corporation, for it is not.

I have personally experienced the financial disasters attributed to the collapse of the energy industry as this collapse relates to my own oil exploration and servicing companies. I have experienced the auction sale of my \$3 million drilling rig in perfect condition, which sold for less than it it had been weighed on the junk yard scales and sold for scrap iron.

Also, I have written off millions of dollars of accounts receivable from similar companies and shut in dozens of wells that are not

economical at today's oil prices.

I am presently fighting for the financial survival of my real estate company and, in doing so, have experienced most of the problems associated with the real estate industry and the inability to maintain the ownership of properties, even with large current appraised equities, in a market with very little available credit.

I am witnessing the label of "crook" being placed on good people that made credit decisions in the origination or funding of loans that by hindsight and fueled by a regulation strangulation of the real estate industry are proving to be less than prudent decisions

by today's standards.

In the Dallas area alone, 5,282 business firms and individuals sought bankruptcy protection in 1986 and even though this number has increased over 55 percent from the 1985 bankruptcies, the accounting firm of Price Waterhouse predicts that Dallas' failures will continue to rise and not peak until perhaps 1988, and it is the real estate sector that the firm believes will continue to experience a rising number of failures.

I sincerely believe that in testifying here today and in objecting to the extremely tight monetary controls of the Federal Home Loan Bank that are exacerbating the real estate and thrift industries in my area, that I am risking retaliation by the very entity that must approve the forbearances my company may need from

lenders.

However, I also believe that it is imperative, no matter the cost, that this committee in public hearings be informed of the problems facing the real estate and thrift industries from the perspective of the very people experiencing these problems.

This concludes my statement. I will be happy to answer any of

your questions.

[The prepared statement of Mr. Sullivan can be found in the appendix.]

Chairman St GERMAIN. Thank you, Mr. Sullivan.

Now, we will hear from Mr. Scott Hudson of Dallas, TX. It says here that you have owned S&Ls and commercials?

Mr. Hudson. Yes, sir, I have. I have owned them, Mr. Chairman. Chairman St Germain. And you are a former prosecutor, and there are allegations there are prosecutions going on here.

So we will put your statement in the record, and you may pro-

ceed.

STATEMENT OF SCOTT HUDSON, FORMER OWNER OF SAVINGS AND LOAN ASSOCIATIONS AND COMMERCIAL BANKS AND FORMER PROSECUTOR, DALLAS, TX

Mr. Hudson. Mr. Chairman, and may it please the Members of this committee, I have experience as an owner of banks, as an owner of savings and loans, as a director, as the executive of several banks, several savings and loans, and as the legal representative of borrowers and lenders, as an investor, and as a borrower, and as a prosecutor.

I have also had the high honor of working on investments for a man whom you knew by the name of Sam Rayburn, who worked

right here in 1957, 1958, 1959, 1960.

Over a period of the last 10 years the savings and loan industry has gone through many agonizing and perplexing problems. One very significant change has been the deregulation of savings and loans.

Our country, and particularly my State of Texas, has been faced with a myriad of economic problems and dislocations. One significant problem was dealing with a cartel named OPEC, over which

we had very little, if any, control.

It was this cartel that created the unprecedented inflation, and therefore the economic chaos, in almost every walk of an ordinary citizen's life. In dealing with the economic dislocations, our government created a policy that envisioned energy independence. That policy created demands on the financial system that were unprecedented, and in that regard made the task of the Federal Home Loan Bank System most difficult in coping with the demands placed upon it.

In my opinion, the Federal Home Loan Bank System and the Federal Savings and Loan Insurance Corporation as well as the Federal Reserve Bank and the Federal Deposit Insurance Corporation became extremely frustrated and began to point their fingers at management of the various savings and loan institutions and

banks and created an adversarial relationship.

The Federal Home Loan Bank Board should have closed ranks with the various institutions to solve the many problems which were created, a significant portion of which were economy driven as opposed to management driven.

The purpose of the Federal Reserve System and the Federal Home Loan Bank Board System is, simply put, to expand credit in a contracting marketplace and to constrict credit in an expanding marketplace while at all times ensuring that public confidence exists in financial institutions, as well as to ensure that sound and prudent lending practices are being followed.

For the reasons mentioned above, predominantly oil and gas and the deregulation of savings and loans, the State of Texas is currently in a contracting marketplace, and you have heard that from

nearly everybody at the table.

The policies of the Federal Home Loan Bank Board have been counterproductive in the recent past, since they have restricted the availability of credit. To partially support this contention, it is my belief that all of the following policies have been counterproductive, and I list nine:

The position that all financial institutions should immediately book a reserve to reflect the current market value of real estate held as collateral. This is in direct contravention to the generally

accepted accounting principles.

The unwillingness by regulators to consider the financial capacity of the borrowers to repay loans. People repay loans. Property does not. When was the last time you got a check from a house?

The unwillingness by regulators to allow management to support

its position. No check and balance.

The position regardless of market conditions that certain properties must be foreclosed exacerbates an already critical market situation.

The formulation of secret lists which prohibit without cause certain named individuals from obtaining credit. Blacklists are being used without notice to the individual. Discrimination. No check and balance.

The inability to renew loans on a basis that gives borrowers necessary time to repay loans. No consideration of economic circumstances.

The threat by regulators that employees will lose their jobs. Extortion without recourse. No check and balance.

The diversification of investments should be encouraged, not pro-

hibited by red lining. No check and balance.

The threat that institutions will be put into receivership ought to be the last resort. Extreme remedy without due process. No check and balance.

Without being accusatory of individuals who were and are involved in the regulatory process, I would point out to you that our government has operated best when it operated with checks and balances as the framers of our Constitution intended.

The framers of the Constitution understood the axiom that "absolute power corrupts absolutely," however the Federal Home Loan Bank System, the Federal Savings and Loan Insurance Corporation

olaces absolute power in the hands of a few.

It is fine to say that after an association or financial institution has been taken over by a regulatory agency, we will give them recourse to the courts, but the plain fact is that the game is over and the local community is out in the cold.

My recommendation to your committee in dealing with the problems that now exist, where frequent charges of arbitrary and capricious action by examiners and supervisory personnel have been made and continue to be made, is to provide for a check and balance in the form of an independent general counsel appointed and employed by your committee in each of the Federal Home Loan Bank Districts.

Such an independent general counsel should be given the appropriate staff and responsibility to represent the various Federal Home Loan Bank Districts, but report directly and only to Con-

gress

It should be obvious that a general counsel employed by the Federal Home Loan Bank Board and not Congress is nothing more than a hired gun who takes his orders from the Board, its officers and supervisory agents, and owes his job to those employers.

Therefore, it would be improbable, if not impossible, for the general counsel in each district, as it is now presently constituted, to ask the appropriate questions, receive input from local communities, and advise with the local Congressional representatives as to

what might be in the best interest of the local community.

Obviously, Mr. Chairman, no one would countenance a crook in charge of a financial institution, and where there is strong evidence of wrongdoing or, for that matter, any evidence of wrongdoing is brought to the general counsel's attention, it is clear in my

mind that an immediate investigation should take place.

In proceeding with such an investigation, it is only logical that the resources of the local communities should be available to the general counsel; that is, local district attorneys, local United States attorneys, local police agents, as well as Federal agencies, and if the allegations of misconduct are credible, then obviously corrective action could and should be taken, all of which should be in the light of day.

The other side of the coin is that if those allegations are incorrect and ill-conceived then appropriate actions should be taken with regard to the regulatory agency. The latter is improbable

under the present situation because of paycheck loyalty.

I have read H.R. 27, H.R. 1063, as well as the various financial plans put forward by the United States Savings and Loan League, the Treasury Department and others. There are good points in each of the plans; all present methods to get the necessary capital which is so desperately needed. The question that is burning in my mind is:

What happens after you give them the money? Will the abuses of the past continue in the future? Where is the check and balance with regard to the regulatory misconduct, arbitrary and capricious behavior by the personnel of the various regulatory agencies?

Perhaps I ought to address the question of forbearance; that is, time and patience, which is the subject of legislation proposed by

four eminent Members of your committee.

I agree with the thrust of their bill and the many technical matters contained therein. However, it does not address the question of how to control the regulatory agency which seems to have run amok.

Considering the need, I cannot imagine a situation where a regulatory agency would object to a representative of Congress, a general counsel appointed by the committee in each district, unless they felt they had something to hide or that due process and checks and balances should only be applicable to others.

And in this regard, Mr. Chairman, we only have to look at the

recent past to understand this situation.

Just let me tell you, if you had a general counsel in the basement of the White House, you wouldn't be in Irangate.

Thank you. I will be happy to answer your questions.

[The prepared statement of Mr. Hudson can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Hudson.

To introduce our next witness, I'll call upon a very distinguished Member of both this subcommittee and the full committee, Mr. Roemer, of Louisiana.

Mr. Roemer. Thank you, Mr. Chairman.

Our next witness is from Lake Charles, Louisiana. We have invited him, part of me says, to get out of Texas, but I don't mean that. There are a lot of good folks in Texas, but Louisiana has had more than its fair share of problems, some self-imposed, some swept up in the tides of economic movements.

But the next witness is one of the leaders in the savings and loan association in our State. He's well thought of, Mr. Chairman, from north to south in our State. I don't always agree with him, but I always respect him. He's one of the best, Jim Fogleman.

Jim is chairman of the board of the Louisiana Savings Associa-

tion, chartered since 1909, with about half a billion dollars.

Mr. ROEMER. Mr. Fogleman, before you begin, I've got to say it's a fact, you know, that he doesn't always agree with you. But don't feel badly about it. [Laughter.]

You're not alone.

We'll put your entire statement in the record. You may proceed.

STATEMENT OF JIM FOGLEMAN, CHAIRMAN AND CEO, LOUISIANA SAVINGS ASSOCIATION, LAKE CHARLES, LA

Mr. Fogleman. The economy of Louisiana is, as was stated earlier, certainly a disaster and it is a disaster as a result of the energy problems, agricultural problems and declines in shipping from our ports.

All the evidence seems to point towards further declines in our economy. Our unemployment in Louisiana at the present time is 14.3 percent, the worst than in any of the 50 States, and almost

twice the national average.

There are 102 associations in Louisiana and the total assets of them are about \$15.6 billion. Thirty-eight of these 102 lost money during the first three quarters of 1986; the net losses of all the 102 associations for the 9-month period ran about \$9 million a month.

Our customers are hurting. When our customers hurt, we hurt. The prospects for 1987 are much, much worse. Most of these associations are well-run by competent managers and directed by responsible boards.

The economic conditions simply make it impossible to operate profitably. In order for these associations, many of them, to survive and continue to meet the needs of their customers, they must have

regulatory forbearance until economic conditions improve.

Because of my senior citizen status and long years in the business, I have received many telephone calls from managers relating horror stories of substantial writedowns on assets as a result of our 4lC appraisals that are required by regulations and on properties acquired by foreclosures.

acquired by foreclosures.

These appraisal writedowns as

These appraisal writedowns are in reality a substantial part of the losses previously referred to. As economic conditions improve in Louisiana—and they will—the value of these properties will improve and we may well find that the losses need not have been recorded at all.

Unless capital requirements and asset writedowns are substantially relaxed in well-managed institutions, many of them will be problems of the FSLIC long before the economic recovery would have made them whole.

In order that the Federal Home Loan Bank Board itself may be fully protected and directed in the administration of its duties, I urge your favorable consideration of the Bartlett bill by amend-

ment, or however it's appropriately done, to H.R. 27.

I sincerely believe that the completed version of the amendment, after it has completed the legislative process, will largely explain the concensus attitude of this Congress and will greatly assist the Federal Home Loan Bank Board.

FSLIC will require substantial additional funds to deal with the problem cases it currently has and those it will acquire, even with

forbearance policies in effect.

It is impossible to accurately predict just how much will be needed, just as it is impossible to predict when the economy will improve.

It is for that reason that I respectfully urge the favorable consideration of the U.S. League's 2-year plan to recapitalize the FSLIC.

The details have been carefully considered by the members of the largest and most professional trade organization to represent the business.

These are the folks that are paying the bills, these are the folks that will continue to do so. Just to illustrate in a very personal way, the stockholders in my own company are being assessed at the rate of \$1,500 a day to pay for problems we did not create and did not have the authority to prevent.

We must minimize that assessment. I respectfully urge this subcommittee to approve the 2-year recap plan of the U.S. League.

The approximately \$5 billion a year for each of 2 years that we, the business, will be making available to the Federal Home Loan Bank Board must be wisely used. All evidence by those that are very knowledgeable in the area, including representatives of the Treasury, has suggested that \$5 billion a year is all that can be wisely used by the Federal Home Loan Bank Board.

During the past decade, the ineffectiveness and lack of stability of the leadership of the Federal Home Loan Bank Board has been a significant part of the cause of the problems in the industry, both in failing to prepare for the interest rate crisis that battered the reserves of the associations and in allowing the undesirable high

flyers that have cost us so much.

If adjustable rate mortgages and the greater operating powers that were granted by the Garn-St Germain had been granted 5 years earlier, then much of the impact of the interest rate crisis could have been avoided.

You, Mr. Chairman, and the other Members of Congress granted these powers when the needs were presented to you. Had those needs been effectively presented to the Congress at the same time as the cost of savings in the form of money market certificates, thus freed from Reg Q and allowed to follow the market interest rates, then the results of high rates would have been substantially reduced for the business.

If the supervision had been more effective, the devastation

caused by the high flyers could have been greatly reduced.

In at least one instance which has been widely discussed by the people in the business, individuals who had been in control of an association had become a problem case of the FSLIC were allowed to have another charter.

And now that second association is also a problem of the FSLIC. Millions of dollars of losses will now have to be absorbed by the

rest of us.

The problem is, in my opinion, the structure of the Federal Home Loan Bank Board. The present three-person board is simply not large enough to deal with what has become an industry of widely different types of associations.

The lack of continuity caused by too few Members serving for terms that are not long enough and on a staggered term basis has kept the Board from providing a stable and effective leadership

that is essential.

The individuals who have served on the Board during this past decade have struggled to provide the needed leadership. I don't know of one of them, and I think I've known them all of many individuals who have served during the past 10 years, who haven't given a good honest effort.

They have collectively done a pretty good job in the face of over-

whelming odds.

I think the magnitude of the responsibility and the odds they have against them have contributed to the fact that they haven't stayed on the Federal Home Loan Bank Board in many, many cases for the full term. They've served a short period of time and the result of that, the continuity has not been preserved.

The frequency of turnover has made it difficult to attract and keep top staff members. At the very time that FSLIC is having more problems than at any time in its history, there is no director.

more problems than at any time in its history, there is no director.

The last person who served as the director of FSLIC was an executive on loan from one of the Federal Home Loan Banks, and he has recently returned and gotten a nice promotion as the President of one of the Federal Home Loan Banks.

We, therefore, find ourselves in the unique position of asking the Congress to provide the vehicle for making available \$10 billion of funds which will come from us, our industry, to an agency that has

no director.

I believe the funds must be made available, but I believe that the Federal Home Loan Bank Board must be restructured at the same time.

I sincerely believe that a larger board, serving longer, staggered terms, is essential to direct this industry through these troubled times and to minmize the cost and prevent the reoccurrence of the costly dilemma of today.

Perhaps it should be patterned along the lines of the Federal Reserve Board, and perhaps also it should have representation on a rotating basis from the presidents of the District Federal Home Loan Banks.

I respectfully urge this committee to consider such an amendment to H.R. 27 that would create a board of from five to seven members, serving terms on a staggered basis of at least 5 years.

Since funds for recapitalization will in part be provided through our own Federal Home Loan Bank system, I believe that the considerable talents of some of the bank presidents should be utilized by adding a couple of them to the Board on a rotating basis.

This, I believe, will be a major step toward reestablishing the strength and stability that's needed in our industry if we are to continue to serve the home loan needs of our country.

Thank you very much.

[The prepared statement of Mr. Fogleman can be found in the appendix.]

Chairman ST GERMAIN. Thank you, Mr. Fogleman. Again, we call on Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman. And, thank's, Jim, for your testimony.

Next, another Louisiana representative with the same sort of background as Mr. Fogleman. He comes from the central part of the State, Lafayette. He's president of the Lafayette Building Association, a Louisiana savings and loan that was mutually chartered in 1900, with about a quarter of a billion dollars in assets and a net worth of close to 7 percent.

He's got a deep feeling about the role of savings and loans to provide home ownership opportunities to Louisianians and to Americans

I welcome Don Guidry to our Banking Committee.

Chairman ST GERMAIN. Mr. Guidry, we'll put your entire statement in the record. You may proceed.

STATEMENT OF DON GUIDRY, PRESIDENT, LAFAYETTE BUILDING ASSOCIATION

Mr. Guidry. Mr. Chairman, Members of the Committee. My name is Don Guidry. I am President of the Lafayette Building Association, a Louisiana savings and loan mutually chartered in 1900 with current assets of \$236 million, and a net worth of 6.8.

The savings and loan industry has been my livelihood since 1959. I've seen the dream of home ownership through the eyes of many people. I have also witnesses the dream turn to nightmares for many.

Sure, today, the FSLIC and the savings and loan industry has great challenges. However, our consumers are the ones with the greatest challenges.

I come before you today with a tremendous sense of urgency. I've been out of work for 6 months. We've used all our savings; we've

sold everything we could to make our house payments.

But, I can't pay any more. I can't refinance. Our credit has gone bad. We can't sell our home. The new appraisal is now \$20,000 less than my loan balance.

What are we going to do?

These are several remarks made by consumers today, consumers who were never even 30 days late making payments and now are losing their homes. And this could be you if you lived in Lafayette, LA today.

I'm truly confident with our government's ability to act, not react, to our present situation and with our legislators being supportive, we will maintain the stability of our thrift industry while preserving public confidence in the safety and soundness of our institutions.

Our challenges today are the direct results of legislative history,

changes we made to assure home ownership.

Our Congress has always been supportive in providing ways to better serve our communities. Now, times have changed and these provisions for home ownership, while they did work, must be directed to the preservation of our dream.

Before addressing the issues at hand, let's understand briefly what led us to our challenge. Regulation Q. Our concern for the small saver led us to the sense of the Senate resolution. Tax exempt bond issues. Restructuring below market loan portfolios, and when we're unhealthy, we are subject to further disease.

This is resulting in many dollars that have been spent by FSLIC in permitting new charters and acquisitions by people interested in capitalizing on an ailing industry rather than interested in provid-

ing a service to our communities.

Additional dollars were spent on firms unrelated to our industry in assisting many thrift institutions to restructure loan portfolios. These firms gained profits for themselves at the expense of FSLIC.

My comments are directed with upmost urgency and in priority form due to deepening economic depressions, not only in Louisiana, but in various States.

This depression will continue to spread to other States if priorities are not followed.

First, we need a forbearance policy for well-managed institutions located in economically depressed areas by our regulators and our supervisory agencies. This will provide workout plans for that reserve allocation due to economic conditions.

Second, classification of assets regulation adopted by the Federal Home Loan Bank Board in 1986, must be removed when property is secured with real estate.

We must appreciate the fact that depressed areas are temporary in nature.

Third, new appraisals on property acquired through foreclosure or property held over a year must be discontinued as used to af

current operating profit and loss. These appraisals reflect de-

pressed prices rather than value.

Fourth, remove the regulatory capital requirement in areas economically depressed, as it creates a disadvantage to consumers desiring to bring deposits to the well-managed institutions. Their deposits will have to earn rates less than market or these dollars will deteriorate our base in loss of savings accounts. Even the well-managed institutions will be encouraged or forced to take undue risks to increase earnings. It is an encouragement of risk taking to our industry as opposed to soundness.

Assistance to FSLIC is necessary in the form of the U.S. League's plan. The FSLIC and the industry must not be burdened with huge debt services, especially at a time when the amount of dollars

really needed cannot be determined.

The important point is that something must be done now to assist the industry in the economically depressed areas and not to provide FSLIC with a level of funds as if the whole country were economically depressed.

Our Congress is working hard to bring these areas back into production, and as this occurs the market will provide many dollars that will otherwise become part of the debt so huge that the even-

tual solution will be financed by our public.

We must look to a self-help plan, with strong commitments from our Congress, FSLIC, our industry, and our regulators. Again, in order of priority:

First, a temporary moratorium must be placed on the dumping of assets in economically depressed areas. These actions penalize well-managed institutions, consumers have equity positions, and the resources of FSLIC.

Second, identify well-managed institutions.

Third, a financing corporation as proposed in H.R. 27.

And, fourth, new charters should be denied insurance of accounts for a period of 5 years, as this would provide time for management

to prove themselves to be a service to the community.

Fifth, assets of the ailing institutions that would be acquired through recapitalization dollars should be held, not disposed of, and used as collateral for perhaps the issuance of zero coupon bonds based on the assets at current appraisals. This would be retired in 5, 10, 15, and 20 years as the real estate market appreciates. The end result would be an infusion of capital to the FSLIC at the expense of neither the industry nor the consumer.

Sixth, an incentive provided to financial institutions through advances at below market rates up to the loan values on real estate owned properties would permit institutions to retain these REOs rather than selling them, as this would otherwise create a false selling market. The funds acquired through the advances would be reinvested perhaps in a designated asset to bring a 2 percent margin to the institutions, and as the market improves and properties are disposed of the advances would be retired and the associations could sell these designated assets and reinvest elsewhere.

I have appreciated the opportunity to testify before this committee. I look forward to positive action on the part of the committee, the House, the Senate, and the Administration in addressing the issues affecting the industry, FSLIC, and, most important, the preservation of our American dream, home ownership.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Guidry can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Guidry, and, by the way,

I enjoyed listening to you, with a name like St Germain.

Mr. Guidry. Merci.

Chairman St Germain. Je vous en prie.

Now, we will hear from Mr. Donald Roby, President of the Farm and Home Savings Association of Nevada, MO. We will put your entire statement in the record, and you may proceed.

STATEMENT OF DONALD F. ROBY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM & HOME SAVINGS ASSOCIATION, NEVADA. MO

Mr. Roby. Thank you, Mr. Chairman and Members of the committee.

My name is Donald F. Roby. I am president of Farm & Home Savings Association of Nevada, MO, and I am here today to present my views on H.R. 27, H.R. 1063, and other matters relative to the thrift industry.

Farm & Home Savings Association is a \$3.3 billion State chartered publicly held savings and loan association headquartered in Nevada, MO. The association was founded in 1893 and has 76 of-

fices throughout Missouri and Texas.

I joined Farm & Home late last summer, and immediately prior to that I was President of the Federal Home Loan Bank of Des Moines. I was a member of the U.S. League's FSLIC Task Force and served on the Subcommittee on Regional Problems.

All of us in the savings and loan business appreciate the time and effort being expended on the matter on recapitalizing the FSLIC and on the many facets of the problems attendant thereto.

My own view, and I am confident the view of the large majority of the people in the industry, is that the restoration of fiscal integrity of the FSLIC is paramount. The plan presented in H.R. 27, as well as the plan presented by the U.S. League, focus on the problem, and it is important that something be done.

My personal preference is the plan advocated by the U.S. League because it seems to provide as much cash flow in the first 2 years and appears to be less costly overall. Then, too, additional Congressional oversight is a built-in part of the program in the event that

additional funding is required.

Those presenting the plans seem to take extreme views as to adequacy of funding, timeliness, and other features. One fact that both plans seem to agree upon—the industry pays the bills. Any funds taken out of the Bank System reduces the income available for dividends to the member stockholders any way you do it.

Therefore, it would seem more logical to start with a smaller plan and expand it if and when necessary, but certainly after ade-

quate staffing has been acquired.

The feature calling for an advisory committee seems like a good step in order to provide increase accountability. Most of us would agree with the old adage that people tend to do what you inspect

rather than what you expect.

H.R. 1063 seems to cover all the points of forbearance recommended by the U.S. League task force, and more. The subcommittee of which I was a member recommended that the Bank Board adopt a policy of forbearance similar to that adopted by the other Federal banking agencies in April of 1986.

I personally would favor legislation which gives firm direction to regulators rather than spelling out the details. For example, accounting rules and interpretation change over time and regulators, and the industry, need some flexibility to respond. I can't believe that a strong sense of the Congress message could or will be overlooked by those affected.

While I certainly agree with most of the items contained within H.R. 1063, I am concerned about the first provision of the proposal which would provide for the amortization of losses by qualified as-

sociations on qualified loans.

In general, accounting treatment which is different from the standard or from generally accepted accounting principles usually causes continuing problems. Differences require footnotes and explanatory material, and the industry suffers from the charge of

funny accounting.

I am aware that the Federal Home Loan Bank Board has very recently released a formal policy on forbearance. It appears to go a long way in responding to the need of forbearance and in bringing about some needed change. It is difficult to comment upon it, in that it has so recently been issued, and further, some of the news releases, at least that I have read, only refer to changes which will be made without specifying what the changes will be.

It does not, it seems at this time, adequately cover the need to evaluate loans in accordance with GAAP. I believe that change

needs to be addressed.

Finally, you asked for my comments relative to charges of arbitrary and capricious actions by examiners and supervisory personnel. I have heard some of those comments, and I am sure that they are not all without foundation.

Prior to the rather recent transfer of the examiners to the Federal Home Loan Banks, the examination function was hampered by inadequate numbers of staff, and it was extremely difficult to retain experienced personnel. As a result, some of the districts were woefully behind schedule in examining member institutions.

During the past 20 months, there has been a significant increase in both the examining and supervisory staff. A massive training effort has been underway since that time in order to provide the

most qualified personnel to this important function.

To aid in that training, the Office of Education was established by the Federal Home Loan Banks, and it has been steadily increasing its role over the past 2 years. Increased salary schedules and benefit plans have allowed the banks to attract many highly qualified and skilled individuals to both the examining and supervisory activities.

In other words, I believe the improved quality of these staffs will go a long way in responding to some of these problems.

I would further suggest that there is a strong need for management officials in the thrift industry to take a proactive role with respect to their problems as they develop rather than a reactive role.

That is, they need to quickly recognize their problems and develop at least a proposed plan of workout. The next step, I would suggest, would be to schedule a meeting with the examination and/or supervisory personnel, including the PSA, if necessary, in order to clear the air and start the corrective processes.

While I certainly cannot speak for all of them—as a matter of fact, I can't speak for any of them any more—I don't know of any PSA who would not be willing to work with member institutions in

programs of rehabilitation.

Thank you very much for the opportunity to appear here today. [The prepared statement of Mr. Roby can be found in the appendix.]

Chairman St GERMAIN. Thank you, Mr. Roby.

Our next witness will be Mr. Nolan Rumbley, who is executive vice president of American Federal Savings of Des Moines, IA.

Mr. Leach. Mr. Chairman, I think it worthy of note that this is one witness that has a particularly impressive background, based upon the State he represents.

Chairman St GERMAIN. Ah, Iowa.

We will put your entire statement in the record. You may proceed.

STATEMENT OF NOLAN L. RUMBLEY, EXECUTIVE VICE PRESIDENT, AMERICAN FEDERAL SAVINGS, DES MOINES, IA

Mr. Rumbley. Thank you, Mr. Chairman.

My name is Nolan L. Rumbley. I am executive vice president and chief operating officer of American Federal Savings and Loan Association of Iowa, located in Des Moines.

I appreciate the opportunity to appear today to present my perspective on the Federal Savings and Loan Insurance Corporation recapitalization and the need for effective forbearance as part of your legislative consideration.

American Federal has \$1 billion plus in assets and is Iowa's largest savings and loan. We are a statewide financial institution serv-

ing markets from 22 branches in Iowa.

Our investment in first mortgage real estate loans is approximately \$820 million, and we have approximately 150,000 customers

throughout the State.

As a priority, American Federal has always supported its local markets when considering investing its available funds; however, at times Iowa has been a capital excess State, and approximately \$400 million of our loan portfolio are loans that we have purchased primarily out of State. Approximately, \$103 million of our purchased loans are from the State of Texas, with approximately \$72 million from Houston.

This investment position makes us very involved with the State of Texas and its economy. We find ourselves in a position of being domiciled in an economically depressed State due to agriculture

with major investments in another economically depressed State due to oil.

Our position also illustrates that economic problems are not necessarily limited to specific geographic areas. For an area of any size, city, State, or region to become economically depressed there must be a reduction in the demand for the products and services

provided by that area.

The ability of an economically depressed area to return to full capacity to provide those same products and services remains. The facilities and workforce are available for utilization to produce alternative products and services. As has been proven in the past, an economically depressed area will regain economic strength with the passage of time.

For this reason, any FSLIC recapitalization and accompanying

forbearance should include the following considerations:

Economically depressed areas will regain strength with the pas-

sage of time.

Real estate valuations in economically depressed areas should include the value that will be regained in the foreseeable future.

What may appear to be corrective actions by the FSLIC due to economically depressed areas should not be applied in strength at the height of a crisis, at the bottom of market values.

I believe there is a necessity to recapitalize the FSLIC and maintain its independence as a promoter of thrift and home ownership.

I also believe that the recapitalization should be done conservatively and in conjunction with some type of forbearance to minimize cash needs and help maintain as much of the savings and loan system as is possible. Future increases in real estate market values would be realized and will strengthen the financial position of savings and loans located in and with investments in economically depressed areas.

If the FSLIC recapitalization were to provide large amounts of

discretionary funds, I would have the following concerns:

That the FSLIC would not be able to administer the funds properly due to facilities and staffing.

That over-reacting would eliminate many savings and loans that

could be viable financial institutions in the future.

That a major disposition of problem assets would further depress

real estate values in economically depressed areas.

The recapitalization plan proposed by the United States League of Savings Institutions, along with an effective forbearance plan, would seem to eliminate the above concerns. An effective forbearance plan is an essential pat of an FSLIC recapitalization. A forbearance plan should be for savings and loans located in and those with investments in economically depressed areas. Savings and loans that are well-managed and have shown good business judgment in the past, savings and loans that will be viable financial institutions in the future.

A forbearance plan should include the following:

Forbearance from net worth requirements, due to loans in economically depressed areas.

Avoidance of excessive write-downs by:

Use of generally accepted accounting principles, when accounting for problem loans.

Use of a real estate evaluation process that would recognize potential future values.

Amortizing losses to avoid overstating while economic recovery occurs.

Elimination of the double penalty imposed on problem, incomeproducing properties through classification of assets and scheduled items.

The above would minimize the short-term cash needs, the overall cash needs and excessive carrying costs of the FSLIC.

In conclusion, I believe there should be a recapitalization of the FSLIC that is conservative and accompanied by effective forbearance for savings and loans holding loans in economically-depressed areas.

Thank you for your attention. I look forward to your questions. [The prepared statement of Mr. Rumbley can be found in the appendix.]

Chairman St GERMAIN. Thank you, Mr. Rumbley.

Now we will hear Mr. James Turner from Topeka, KS, president of the Kansas League of Savings Institutions.

Mr. Turner, we will put your entire statement in the record, and you may proceed.

STATEMENT OF JAMES R. TURNER, PRESIDENT, KANSAS LEAGUE OF SAVINGS INSTITUTIONS, TOPEKA, KS

Mr. Turner. Thank you, Mr. Chairman. It is not my aspiration to testify before congressional committees, and I will attempt to limit my remarks to the contents of your letter of February 24 and those areas you asked us to address.

Chairman ST GERMAIN. Mr. Turner, I am going to ask you, since you are representing the Kansas League, to add one little additional item to the request to testify, and that is as follows: of those troubled institutions that you mention in your statement, are they typical of the Kansas thrift that was closed by the Home Loan Bank on February 27? That institution was First Federal Savings and Loan of Beloit, KS, which funded out-of-State real estate, exotic ventures and, boy this is a doozy, a Hungarian movie about a rock band chased by a man-eating bear, the title of which was "The Predator."

Now according to the American Banker, the Beloit thrift was one of 18 throughout the country that was identified as having dealt with First United Fund Limited, a New York money brokers firm, whose activities have been investigated by agents of the Federal organized strike force.

I would like you to tell us whether any more institutions in your league have had dealings with this particular brokerage firm and which movies they are investing in.

You may proceed—or which bear. Mr. Barnard wants to know which bear. And of course, if you can tell us how we can control such excesses.

Mr. Turner, we look forward to your observations.

Mr. Turner. I'm not looking forward to it maybe as much as I was about a minute-and-a-half ago! [Laughter.]

But lest anyone nod off, one of the problems that I have, in addition to that that you alluded to, being from a small State, it was necessary to put our testimony together last Thursday and stop the other things that we were doing on Friday to reproduce 175 copies for this committee, which, as an aside, wiped out our mail budget for a week-and-a-half! [Laughter.]

By doing it on Friday, several events have occurred, so I really

plan to only summarize the testimony that I gave you.

The first of those alludes to the fact that the Kansas League is comprised of 57 associations. That is now, as of today, 56. We have about \$16 billion in assets, and contrary to some others appearing here, our purposes here are really to support recap and forbearance, because of the erosion we see in our State. In the four States that comprise the Tenth Federal Home Bank District, I am pleased to say that our membership, on average, has net worth in excess of 5 percent. We had an outstanding earning year in 1986, but we also saw our real estate loan repossessed assets increase by 58 percent. We see quarterly the numbers of negative earning institutions increasing.

I am not avoiding your question, Mr. Chairman. I am going to

get to it when I finish with my brief summary.

We are here to support recapitalization. We applaud your efforts and that of Mr. Wylie, introducing H.R. 27. We think it is an excellent starting point. Our membership would support a reasonable dollar amount. We would prepare the \$5 billion that is promoted by the U.S. League, although I am not shilling for that position. I am too controversial to appear here as their representative.

We would support that for two reasons. One, the debt overload to our members in excessive dollar amounts beyond that, and secondly, because concerns expressed here as to whether or not the FSLIC could really adequately manage more than \$5 billion a year. And I think Kathleen Day, in the Post on Saturday, pointed out the prob-

lems

Our major reason for being here, though, is to support forbearance and to ask that this committee seriously consider mandating forbearance. I can do a laundry list of some thing that might be in Congressman Bartlett's bill and others and introduced as an excellent departure. I am not sure that I feel that all those points need be legislatively put there, because someday, and I hope that we don't have forbearance forever, you are going to have to come back and change that.

So to the extent that this committee could instruct or would instruct the Federal Home Bank Board to issue forbearance and specify certain key segments of that, we think that would be a much better approach, but we need forbearance. We need it for a number, I think, of very valid reasons. One, we are an economically depressed State, Kansas. When you are dependent, primarily, on agriculture and the oil and gas industry, I don't have to run a lot of numbers by you. Things are tough.

We are seeing some slight improvements in the Ag economy, and I, for one, do not believe that the price of oil is always going to stay down. And I think the oil and gas industry will resolve itself. And I think if we can buy time over a period of time, through a valid forbearance program, then many of these institutions can recover.

If we don't have forbearance, then I think it is rather an act of folly to think that we can do it only with money at this point in time. I think that to look at a money only solution is terribly short-

sighted at this point.

In addition, it has been alluded to, the supervisory examination problems, and I made a rather inflammatory statement in my remarks about them being out of control. Misdirected is probably a better word. And I cited a couple of case studies, Mr. Chairman, that I will not use, because I can't meet your criteria of put up or shut up, because I can't reveal the sources, but I think forbearance with guidance from the Federal Home Loan Bank will allow principal supervisory agents to get a handle on the examination and supervision problem. That has exploded. We have had 150 percent increase in the examination field force in our bank district in 1 year, and we have had an increase from 11 to 29 supervisory agents in the same time period.

Basically, they are going out with regs in hand, classification of assets regs, calculations, R-41(c) appraisals, to ferret out the bad

guys. And to get the bad guys you shoot at everybody.

We think a forbearance program will provide guidance that will help moderate that situation, and we can get back to a better ap-

proach.

I would only conclude—and then I am going to get to your question. It would be easy to come in here and beat up on the Bank Board and the examiners and supervisors, but all of us got into this together. The Congress, when you created us, when you put your staff of full faith and credit behind the FSLIC, and those of us in the State League and the National League positions, the S&L industry and, indeed, the regulators, we all got in this together. We all have this problem together, and we have all got to get out of it together. I want to get out of it without using taxpayer dollars, and I hope that this committee will move as expeditiously as possible to recap the FSLIC but will accompany that with forbearance.

Now Mr. Chairman, to your embarrassing question of the day. I don't I have got any other Members—and that is a former Member now—which relieves some of the pressure to answer. I don't think we've got anybody else that is involved. I honestly don't feel—I know only what I read in the paper and what you've read. That is all I know. And frankly, I certainly don't endorse or approve of that kind of activity. I suspect that now that the institution has been supervisory merged, that we are probably looking at legal actions. And as much as I would like to be entertaining with an answer, I am not desirous of being subpoenaed in legal actions, but I think we will see, ultimately, much of that resolved in the courts, but I think it is way too easy to pull out one bad case, because that gets to the theory that concerns me the most about some of the supervisory process.

I alluded to it in my case study. The old Chinese proverb. If you've got three bad guys out of 100, the best way to make sure you get the three bad guys, is to shoot all 100. I don't want to shoot all 100, nor do I want to label them, because of the actions, the inappropriate actions of one. The bulk of my membership I am extremely proud of. They have done a superb job of meeting the home ownership needs in our State. We finance over 60 percent of

the home mortgages. So I think it would be inappropriate. But we recognize, being in the State, that we have to live with the problem.

[The prepared statement of Mr. Turner can be found in the ap-

pendix.]

Chairman ST GERMAIN. In reality, the most important part of that question that I propounded to you is not really the "Predator" movie but rather the brokerage firm that they were dealing with and my concern about how many other institutions might have been dealing with that firm. Obviously, it is a problem that pervades quite a few areas.

Mr. Turner. There is, Mr. Chairman, an overlapping among many institutions in participation loans throughout the country. One example that I cited in a case study was 12 institutions spread throughout much of the country in a development project. I can't give you a precise number of the number of savings and loan institutions in Kansas that are involved in participation loans. I suspect

a very substantial number, 70 or 80 percent.

Chairman ST GERMAIN. Excuse me, but because we have limited time here, Mr. Turner, what I am talking about is when a money broker comes in and deposits X number of dollars in an institution, and then says, by the way, we have this little film that we think you ought to invest in. It is a quid pro quo. That is the thing that concerns me.

At this point in time, I am going to start the questioning of the

other witnesses, and I would like to make an observation.

In going through the backgrounds of the witnesses and the institutions, I think they are very commendable. I looked at the percentage of the loans in one-to-four-family housing. Mr. Nowlin's institution, 62 percent. Mr. Gross, 55 percent. Mr. Fogleman, 49 percent. Mr. Guidry, 62 percent. Mr. Roby, 79 percent. Mr. Rumbley, 69 percent. Very commendable. That is why the Congress, over the years, and many of us have been such supporters of the savings and loan industry, the thrift industry, because of the mission you have accomplished on behalf of the "American dream," so to speak.

Mr. Nowlin, at page 2 of your statement, the second paragraph, and then you repeat it at page 4 of your statement, "A final concern we have for the continued viability of the S&L industry is the integrity of the ownership and the management of insured institutions. Far too many examples are on record of fraud, self-dealing, insider abuse, speculative or imprudent ventures"—like the one I was just talking about with Mr. Turner—"excessive operating expenses, excessive officers and stockholder compensations, extravagant life-styles, tremendous growth fueled by high rates and often brokered deposits. Using due process and individual judgment at all times, the regulatory authorities must move swiftly and forcefully against this element in our business. Neither FSIIC nor the legitimate, well-managed thrift institutions should be required to pay for the excesses of those managements, not willing to play by the rules."

Mr. Nowlin, as I told you earlier when you finished your statement, that is a very excellent, excellent observation, one that we should all give a great deal of attention to. Let me ask the rest of

the witnesses, does anyone have any quarrel or problem with that statement by Mr. Nowlin?

[No response.]

Do you all subscribe to it?

At this point, I will call on Mr. Wylie. Incidentally, I assume the silence was not reticence, but it was your way of saying that you didn't disagree and therefore, do agree. Is that a correct observation?

Voices: That's correct.

Mr. McKinney. Would the gentleman from Ohio yield to me? Unfortunately, the timing today is not the best and I must leave. Mr. Wylie. I yield to the gentleman from Connecticut.

Mr. McKinney. I used to be on the board of a thrift. I have asked every person that has appeared in front of us to help me with a terrible quandry here. We have State savings and loans in Connecticut, we sometimes refer to them as "wildcat States." They can do any fool thing they want to. But we in the end have to underwrite them. And that sort of bothers me, since I am dealing with your farmers' money, my people's money, everybody's money.

Do you think it is right that the Federal Government underwrite

essentially nonbanking operations? Nobody ever backed me when I was a small businessman. All I really need is a simple yes or no. It

is going to get you in terrible trouble.

Mr. WYLLE. How many vote yes? Raise your hand. How many vote no?

[A show of hands.] Mr. McKinney. Thank you, gentlemen, for your forbearance. I really appreciate that. Thank you.

Mr. Wylle. I didn't want you to use up all my time.

Mr. McKinney. The Chairman charged me not you, because he

is such a decent person.

Mr. Wylle. I understand that all of you support recapitalization, but you are divided as to whether you support the recapitalization plan as submitted by the Administration and the bill that Mr. St Germain and I have introduced, and others support the U.S. League plan. I believe that is a fair analysis of the testimony that's gone on so far.

Now a lot of interest has been expressed along the way, and was demonstrated yesterday by the witnesses, for a provision to deal with the limitation on direct investments. Should any recapitalization proposal we might vote out of this committee also address the

issue of direct investments?

How many of you think it should?

[A show of hands.]

Mr. Wylle. Tell us why it should, Mr. Gross. You raised your hand first.

Mr. Gross. I think it needs to be addressed because at this point in time we have just had a new reg issued, I think last week, last Friday, which will have the effect of reducing direct investment.

For instance, if you had a direct investment, had it gotten paid off while it was grandfathered, you couldn't replace it with a new one if you happen to be in one of these States where the forbearance were in effect, or anything such as this. In many institutions, ours specifically, we are getting killed by the home loans. If it weren't for some of these direct investments contributing some other income source, we would be in worse shape today than we are.

When you are foreclosing a hundred houses a month and there is virtually no building going on, if all you can do is invest in houses, you have really got a problem.

Mr. Wylle. Do any of you feel strongly that that might load up

the canoe, would slow down the recapitalization proposal?

Mr. Turner. Yes.

Mr. Wylie. OK, would you state why?

Mr. TURNER. Mr. Wylie, I think the priority is where we come down. I have heard a number of suggestions that were made in the committee today for other provisos that should be put in your bill, but I think the major issue is:

Do we really need to recapitalize the FSLIC and restore confidence in that fund, to accompany that hopefully with forbearance?

I have some concern about any excess luggage that goes onto the bill. I don't object to it being there, but I would not want to see eight or ten more items added to the bill that would extend the hearings on for a considerable length of time.

That is my only concern, not that I have a great concern about

doing something on direct investment.

Mr. Wylie. Mr. Chairman, I have been given a note that my time has expired. I ask unanimous consent to proceed with one additional point.

Chairman St GERMAIN. I don't hear an objection.

Mr. Wylie. Thank you.

All of you testified today that there should be a provision of forbearance in this bill. Now, that might be additional baggage, according to the definition which you just gave, possibly not. You said you didn't want a direct investment provision.

Mr. Turner. Well, I testified, sir, that we would like that to be a

mandate from the committee with very limited guidance.

I applaud what Mr. Bartlett is doing, and I can support that bill, but I think if we could do it regulatorily, all we are asking is a very small piece of luggage that says that it is the sense of this committee that forbearance should be done.

Mr. WYLIE. Only through institutions that are viable and well-

managed, though?

Mr. Turner. Yes, sir.

Mr. WYLIE. We are all suffering from regional economic difficulty. Now, my question is how do you define this? How do we determine which institutions are well-managed, who is viable?

As I recall, Mr. Guidry stated on page 6 of his testimony that the definition of the well-managed institution should be one at least 10 years old with at least a 3 percent net worth under GAAP.

I would like the opinion of the other witnesses. Would this defini-

tion exclude many thrifts?

Mr. Gross. It certainly would in Texas.

Mr. Wylie. Thank you.

Chairman St Germain. Mr. Barnard. Mr. Barnard. Thank you, Mr. Chairman.

I had listed three things that I wanted to talk about today. One was the recapitalization of the FSLIC and the amount and some of the issues of the forbearance and the Home Loan Bank Board.

Mr. Wylie has added another one that I feel needs to be addressed, but Mr. Wylie asked the question a while ago. I under-

stood the question to be:

How many of you agree that we need to have a direct investment

rule in this legislation?

And I think that three people raised their hands, but when Mr. Gross answered the question, I think he answered it in the negative. So I think that is confusing.

Let me ask the question again:

How many of you think that there should be a direct investment rule in this legislation?

Hold your hand up.

[No response.] Mr. Barnard. Thank you. I just wanted to correct that because I

thought that you all misunderstood, and I agree with you.

Gentlemen, Mr. Gross painted a wonderful picture of why we are here, the inspiration and the emotion that goes on in being a Member of Congress.

Let me say this, if you are nervous about an issue about sitting where you are, let me say this, I am nervous where I am sitting, trying to make a decision on FSLIC. No one here, as I understand it, has supported the Treasury bill, yet we continue to hear testimony from the General Accounting Office, nonpartisan, independent, that says that we are already \$6.5 billion into FSLIC.

How in the world can we fight them while we are sympathetic? And we understand where all of you are coming from. But how in

the world can we ignore that?

That is an arm of the Congress, and they are telling us—and they have studied the picture not from just Texas, but Kansas, from Iowa, Oklahoma, and Louisiana. They are looking at the picture nationwide, and they say that we need \$6.5 billion to balance the books.

Now, gentlemen, this committee is going to have to be reorganized, and it is going to be called the FSLIC Recapitalization Committee because, Mr. Chairman, we are going to be in session every three months trying to determine what the amount to go into FSLIC is.

So I would just ask you. I want somebody to explain to me why we should ignore the GAO, and I will listen to anybody.

Mr. Hudson. Mr. Hudson. No question that you shouldn't ignore the GAO.

The question is when does the GAO look at it?

The GAO looks at it after the fact, and what we are in is a transitional period right now. That is very, very important, and if you listen to me in my presentation a little bit, if you understood, you have got to have somebody on the ground in each one of these situations. You can't describe one policy that is going to help Massachusetts, California, and so forth.

And I agree with the Treasury to an extent. I don't think we have got the length of time that people keep talking about, looking at it economically. I think we have got 6 to 8 months at the best, the way we are right now, and it won't be a question of \$6.5 billion. You will be talking about \$25 billion.

Mr. BARNARD. Tell me, then, why would less money in less time

solve the problem.

Mr. HUDSON. I think it is a question of use of that money after they have got it. That is the burning question in my mind. If you are going to administer that money, you have got to have time to administer it.

Mr. BARNARD. Mr. Hudson, do you think Congress is going to give the Home Loan Bank Board and FSLIC \$25 billion and then start working on something else?

Mr. Hudson. No, sir, I don't.

Mr. Barnard. We are not going to do that.

Mr. Hudson. But I am saying to you, at the time you do it you need to have a rational way of spending it, and you have to have

some sort of way to deal with it.

Mr. BARNARD. Well, right now the GAO tells us that we are dealing with something like 200-plus institutions in conservatorship, and the way they are losing money today at \$1.4 billion a year, that in itself is going to break the FSLIC in 6 months.

So you know, you are talking about what we are dealing with in the present. We are dealing in the present, but we can't go back and restore some 300 savings and loans that the Home Loan Bank

Board admits are broke.

Mr. Hudson. Well, you are going back and restore the FSLIC

that the GAO admits is broke.

Mr. Barnard. Let me ask you my question again: what are we here to do? Are we here to look after the depositors or the investors?

Mr. Hudson. I hope you are here to look after the depositors be-

cause that is what I am. I am not an investor any more.

Let me say to you that you signed a guaranty on every one of those deposits, and therefore guaranteed the loan. If you don't do something to help the persons—and here is a man down here talking about a hundred homes a month. Let me tell you, it is all-pervasive in the real estate market.

When you hit the homeowner, okay, and he is going to get the developer. When they have a cold, the developer, I am afraid, has pneumonia, and so we have got a question of the orderly progression of that money, what happens to it when you get it, do you have regulatory abuses or do you have somewhere to work at it on a community basis.

I am talking about in the community, not on the national scale.

Mr. Barnard. I think it would be impossible for us to structure a system to let every community make the determination. We have got to have a Federal agency to do that.

Mr. Hudson. No argument about that. What you need is some

local input.

Mr. BARNARD. Unfortunately, all of this has not dovetailed at the right time. If—as we all know, the Home Loan Bank Board has been in somewhat of a state of disarray, it has finally got its act together and is going back and putting the examiners at the regional level, which is a good proposition. But unfortunately, see, they didn't do that 5 or 6 years ago. They only did it last year.

Now, these problems that we are having in Texas and Oklahoma and others are not just a year old. They are 5 or 6 years old, when the Home Loan Bank Board did not have the capacity or the manpower and possibly the imagination to come in under the new system and examine the savings and loan industry.

So, unfortunately, gentlemen, we are not dealing where every-

thing comes together at one time.

My time has expired.

Chairman St Germain. Mr. Wortley.

Mr. Wortley. Thank you, Mr. Chairman.

Mr. Sullivan, I am grieved to learn of all of your personal and financial misfortunes. You had to sell your oil drilling rig at a distressed price. You had to write off millions of dollars in accounts receivable. I don't even know how you afforded to get to Washington today for this hearing.

How did you get up here?

Mr. Sullivan. American Express.

Mr. Wortley. In a truck, was that? Did you fly up?

Mr. Sullivan. Yes, sir. Mr. Wortley. How did you fly up?

Mr. Sullivan. Delta in coach.

Mr. Wortley. Delta in coach? No first class?

Mr. Sullivan. No, sir.

Mr. WORTLEY. No private jets, right? Mr. Sullivan. No first class ticket.

Mr. Wortley. Mr. Darby, your associate, mentioned the San Angelo Bank.

Could you elaborate a little more on the situation in that bank? Roughly, what are its assets, and what is its current net worth?

Mr. Darby. I believe last summer, which is about the last form that I am familiar with, the total assets of that institution were around \$180 million, I believe. It had a net worth of approximately \$7 to \$8 million, and I am not familiar with the current status. I know they are under a supervisory agreement, and I do not know, having not seen the final audit report.

Mr. Wortley. You don't know whether they are negative now?

Mr. Darby. I assume they are negative.

Mr. Wortley. You assume they are negative?

Mr. DARBY. Yes, sir.

Mr. Wortley. Maybe before we get done today, you might be able to call down there and find out, based upon the last certified public accountant's report, what their current status is, and maybe you could let me know so we can incorporate it in the record.

Mr. DARBY. That would be fine.

Mr. Wortley. Does that institution have any continuing relationship with its former chairman?

Mr. DARBY. I don't believe so.

Mr. Wortley. Mickey Salley I think was the former chairman, is that correct?

Mr. DARBY. That is correct.

Mr. Wortley. Did you know Mr. Salley?

Mr. Darby. Yes, sir.

Mr. Wortley. You don't think there is any existing relationship with that chairman? Is that what you are saying? You are sure there is no existing relationship between the bank and Mr. Salley perhaps in terms of compensation he might be receiving?

Mr. Darby. I believe Mr. Salley resigned in the position of Chair-

man of the Board back in—I believe it was May.

Mr. Wortley. Was he forced to resign?

Mr. Darby. I don't know the circumstances regarding his depar-

Mr. Wortley. When did your relationship—you said you are not involved with the bank right now—when did your relationship with San Angelo terminate?

Mr. Darby. I have helped the institution for several months

during the fall of last year.

Mr. Wortley. So you were there when the former chairman resigned, is that correct?

Mr. Darby. I am not employed by the institution.

Mr. Wortley. I realize that, but you still had a relationship with the bank.

Mr. Darby. I represented the bank in several workouts.

Mr. Wortley. Several workouts.

But you still don't remember any of the circumstances of his departure?

Mr. Darby. I believe he resigned in May of last year.

Mr. Wortley. For a man who was involved in the workouts of the bank and was as close to it as you were, I am surprised you don't know the circumstances, whether he received some sort of a severance?

Maybe Mr. Sullivan knows. What is the answer to that? Do you know, Mr. Sullivan?

You had some affiliation with Mr. Salley.

Mr. Sullivan. Mr. Salley did resign. It is my recollection that his resignation was tendered to the committee prior to the Federal examination. It was a period of time when the institution was earning in net worth approximately \$7 million.

Mr. Wortley. Did he receive a severance, or is he still on the

payroll?

Mr. Sullivan. At that point in time, just following the exit of their president, who received \$100,000 as severance pay, Mr. Salley

had been there for 27 years.

He requested that in some capacity as a consultant with the S&L that he stay on till age 65, some type of continuing salary relationship, which the S&L Board of Directors chose in lieu of that to award him in the neighborhood of \$75,000, which was vested retirement, and to bring his future salaries—I believe Mr. Salley was in his mid-'50s—to convert his future salaries into some type of annuity plan, which they did buy from him. They subtracted any type of income tax.

I understand that Mr. Salley left with approximately \$75,000 in cash and paid up annuities.

Mr. Wortley. How much did you say that annuity was?

Mr. Sullivan. I believe the entire compensation of Mr. Salley

was in the neighborhood of \$300,000, including income taxes.

Mr. Wortley. This was a troubled financial institution that was rewarding its Chairman of the Board with some \$375,000, is this what you are saying?

Mr. Sullivan. No, sir, Mr. Wortley. That included the \$75,000. That was his.

Mr. Wortley. The \$75,000 was included?

Mr. Sullivan. At the point in time when the Board accepted his resignation, and again I stress it was before their Federal examination and before any writedown that put them in the negative net worth position.

Mr. Wortley. That was pretty good compensation for a man who was presiding over an institution that wasn't doing too well, I

would say.

One last question, what percentage of the assets in San Angelo

were high risk?

Since both of you worked with the bank rather closely, I am sure

you know.

What percentage of the assets were in the category of high risk? Mr. Sullivan. I presume that is in a category other than single family residences.
Mr. Wortley. Yes.

Mr. Sullivan. I cannot answer that. I have no idea.

Mr. Wortley. I wonder if before you folks do leave here today you might have the opportunity to call that bank and then call my office and leave those figures for me, so I can incorporate them into the testimony here.

Would that be possible?

Mr. Sullivan. I don't know if they would share that information with us because they are under Federal supervision, and I am not an employee. But it would be very possible to call and ask them. I certainly will. I do not know if they will share that information with me.

Mr. Wortley. Well, it certainly would be helpful to us to know that information in making our judgments.

Thank you very much, gentlemen, for your testimony. Chairman St Germain. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Chairman, you read to the committee a statement by Mr. Nowlan, which I admit it was profound, and knowing the panel members had an objection, I reread it after the unanimous vote, and I have an objection. Let me just read the last line.

"Neither the FSLIC nor legitimate, well-managed thrift institutions should be required for the excesses of those managements not willing to play by the rules."

I disagree with that statement because I also have a problem paying increased auto insurance rates not because of my bad driving habits but because of neighbors' and because we are in the same rating group, he has an accident, it is reflected in my premiums.

Basically, gentlemen, that is the basis behind insurance, and FSLIC is an insurance corporation, as we all know, and I think, sad to say, some of the excesses have gone on and resulted in losses, and now all of you through your institutions have to pay the piper.

And it seems to me that is the crux of what we are talking about

here through the recap bill.

I agree with Mr. Barnard, who indicates that the speakers who addressed the League plan all seem to come down i

and the surprising thing on the League's plan is, especially knowing what we now know, as far as the severity of the problem, the League plan is totally, woefully inadequate to address the problem, and I would have hoped that you gentlemen here today would have been more realistic and would have come to us with a modified League plan, one which would more adequately address what we are facing today.

I agree, the Treasury plan has not caught on fire before the committee, but basically the League plan is dead in the water, also.

The question I have, and I would like to direct it to three members of the panel, and it is based on the statement made by Mr. Turner, who indicates we got in this together, we want to get out of it together.

But it seems to me as time goes on I hear more and more talk of S&Ls shifting from FSLIC to FDIC, which brings us to the question of incorporating in the bill some very strong language regarding

some exit fees.

Let me ask Mr. Nowlin to respond to what your idea of exit fee is and whether or not you support them, and let me ask Mr. Fogleman to respond and then Mr. Turner.

Mr. Nowlin. Thank you, Mr. Kleczka.

We support the principle of exit fees, which should be affordable and reasonable but consist of enough money to discourage wholesale withdrawal from the FSLIC.

And if I may, sir, let me add one thing. There may be just a little bit of a misconception about which plan for FSLIC recap is being supported. We do not take a position as to which plan. We simply say that some plan. We are not saying only the U.S. League plan, but some plan.

Mr. Kleczka. There are those on the panel which did.

Mr. Nowlin. Congressman Barnard also referred to that, too.

Yesterday, I think you heard testimony from several witnesses that did espouse the Treasury plan or the administration plan.

So I think perhaps what you are really hearing from all of us is

that we desperately need some plan.

Now, many of those here this morning have recommended the U.S. League plan. Perhaps it is up to the Congress to decide which plan, but the basic measure is that we need FSLIC recapitalization.

Mr. Roemer. Jerry, would you yield on the exit fee to our wit-

ness?

Could you be specific on the exit fee?

You said something reasonable on the one hand, but high enough on the other to keep anybody from using it. How are we going to do that?

Mr. Nowlin. There have been two plans that I am aware of that have been proposed.

One is, I believe, ten annual premiums, which is pretty strong. Some people might consider that to be prohibitive, unpayable.

There is another plan that I have heard that talks about two annual premiums and two special assessments.

Mr. Roemer. Which one meets your definition?

Mr. Nowlin. I would say the latter comes closer to what I would think would be large enough to be significant, but affordable.

Mr. Kleczka. The problem of affordability is that it is to your best interest to pay your exit fee when you want, unlike my auto insurance example. If I change policies, change companies, which I thought would be the comeback from some of the panel, if I am the bad actor, I bring along with me that experience. So I save nothing premiumwise, and I don't think that two and two is the thing at which we are looking at.

Mr. Fogleman?

Mr. Nowlin. May I add one thing?

Mr. KLECZKA. No, because—you might adequately respond to it, but my time has expired, and, Mr. Chairman, if I could have unanimous consent to have the two witnesses respond briefly?

Chairman ST GERMAIN. Is there objection?

[No response.]

Mr. KLECZKA. Mr. Fogleman and then Mr. Turner, very briefly.

Mr. Fogleman. Thank you, sir.

I do, sir, favor an exit fee. I think it is a matter of preservation of the integrity of the fund. An exit fee has to be a part of our system. It would simply create an impossible situation if there was to be a considered exodus or walk from the industry.

I believe it would be somewhat presumptuous for me to attempt to quantify that fee just in the very brief time. The numbers, of course, that I have seen are up to 1.3 percent of assets, and I believe we give a range of about .5 of assets or .6 of assets.

But I am just plain not qualified to deal with that. I would have no objection to making a statement on it. I would be glad to study

it and make a statement in the record.

Mr. Kleczka. If you could send to the committee your recom-

mendations, we will be moving swiftly on it.

Mr. FOGLEMAN. If I may comment on the U.S. League, my preference for the U.S. League recap plan, I am simply concerned that the money be wisely spent.

The Treasury Undersecretary in his statement before this committee on January 22 stated that only \$5 billion a year could be effectively utilized by the FSLIC. So there is no point in creating a \$15 billion fund when it can't be spent.

Mr. KLECZKA. Mr. Turner, very briefly?

Chairman ST GERMAIN. Mr. Kleczka, I think in fairness to the others, they can reply in writing, but we should proceed to the other members for questioning at this point in time.

Mr. Roemer is recognized.

Mr. Roemer. Yes. I will yield to Jerry for a brief statement from

Mr. Turner on his question.

Mr. Turner. In response, I don't think anyone here is opposing the Treasury plan. I think we are expressing a preference. I think most of us were on record for that preference before the GAO study.

I might quarrel some with the way they arrive at that. I think you have got to have it. The more you are going to put into the FSLIC recap, the better you would better protect it.

Mr. ROEMER. Thank you, Mr. Turner. Thanks, Jerry.

Back to the question Mr. Fogleman raised in regard not only to the ability to wisely spend the \$5 billion on a per annum basis, in his testimony he talked about the need to restructure the Federal Home Loan Bank Board System.

I wish anybody who would like to comment on two questions:

A, do we need restructuring for the purposes of continuity and competency?

And, B, if that is a "yes," should it be part of this package? Is it of primary and foremost concern, equal to the questions of foreclosure and funding?

Could I have—would anybody like to address that?

And if you are silent on the question, I will assume that Mr. Fogleman is wrong. A, we don't need it. B, it is unimportant.

Mr. Hudson. Well, not at all. A, we do need it. B, it should be

part of this package in order to protect your investment.

It is like a lot of insurance companies, and I will take his example here on the automobile insurance. There were a lot of people that rushed out with lower premiums and got themselves hung, and we have got a lot of bad automobile insurance companies right now.

I don't want to follow their example.

Mr. Roemer. Excuse me, Mr. Hudson. Let me keep you on the question of restructuring.

Now, we are trying to put a bill together, a serious business,

tough work. It will be imperfect.

Now, we don't get you often. Now, give it to me straight.

Is restructuring part of this package? Should it be? Any advice on how to do it?

Now, stick with me right on the point, anybody.

Mr. Hudson. The answer is "yes," and the answer is that I will answer to the committee in writing immediately. It is not something that can be done here today, with the time constraints that we have.

Mr. Roemer. Very good.

Anybody else?

Mr. TURNER. Mr. Roemer, yes, it should be; no, it should not be a part of this package.

Mr. Roemer. Anyone else for the record?

[No response.]

Mr. Roemer. Thank you, Mr. Chairman.

Chairman St GERMAIN. Mr. Nowlin, I am going to give you the opportunity to give your version on insurance.

Mr. Nowlin. Thank you.

In response to Mr. Kleczka's example, I agree that the principle of insurance is that we pay for the losses of our neighbor, like he said, but I don't think we like to pay for the fraudulent claims that are turned into the insurance company.

And I think that is an example of the type of thing that I referred to in my comment, is where the rules are absolutely violated, just incredible excesses are done, and that ends up being paid for by the FSLIC and ultimately by the people who pay the premi-

Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Bartlett.

Mr. Bartlett. Thank you, Mr. Chairman.

I want to thank all the witnesses and the Chairman's selection of the witnesses today. I think the witnesses have brought together a very real world perspective on both the problem and the solution and the direction of the solution.

The fact is that we have a problem. It is an enormous problem. It is a large problem, and it is national in scope, and if we do nothing or do the wrong thing, that problem will damage all depositors, insured depositors in this country, and that includes depositors in Connecticut as well as Texas and Kentucky as well as Iowa.

One of the things that you, the witnesses, have really brought out is that there is a wide range, and the word "forbearance" has perhaps become the most overused word in this entire debate because of its complexity. Perhaps what you have advocated more precisely is regulatory reform or putting some realism into the reg-

ulatory structure.

It will do two things. First, stop having the regulations themselves add to the problem. The problem is economic and, second, to then construct a way that we can work our way out of the problem.

The fact is there are far more institutions that are losing money and today have a negative net worth, leaving aside the 3 percent requirement, than recapitalization could possibly close down and fund.

So we have to find a way, as you advocated, to begin to work

those problems out.

This leads me to my first question. Several of you brought it up in your testimony, but I would just want you to expand on it if you would choose, or others, and that is the issue of closing down institutions that are nonviable.

We heard yesterday that there are a number of institutions, and I think you have alluded to it, that just simply cannot be made to be viable and cannot be worked out under—I think in the words of

one witness yesterday—that are brain dead.

In your judgment, should those nonviable institutions be closed. merged with others, sold, or something else happened to them so that they are closed so that the rest of the industry can survive?

And, in your judgment, is there anything that you have recommended today or anything in the legislation that I have offered that would prevent the closing of institutions that just simply cannot be retrieved they are so deeply insolvent?

Mr. Nowlin?

Mr. Nowlin. Yes, I would agree that they should be closed as soon as is possible and that the assets should be dealt with in a very orderly way.

I believe Mr. Green yesterday testified at some length on that. I

think we would personally have to agree with that.

In order to stay funded, they have to pay much higher rates, which raise the entire level of interest rates that we have to pay, which I am sure is bad news for Mr. Hudson, since he is a depositor.

But it is a fact that the rates in Texas are probably-

Mr. BARTLETT. Mr. Turner, you testified that something like 46 percent of the thrifts in Kansas have negative income or lost money last year.

In your opinion, is a large percentage of those the result of egregious mismanagement practices or the result of something else, and if there are those that are just simply nonviable, should they

be closed, or what should we do with them?

Mr. Turner. We went from 20 percent negative at the end of the first quarter to 32 percent the second quarter, 46—it tracks along with the new classification of assets and increased writedown of loans. That doesn't mean those institutions are failing, but we are eroding their net worth.

So your proposal for forbearance has a direct impact on that.

But our proposal—and I think everyone here—to borrow someone else's expression, what we are really trying to do is heal the sick; we are not trying to raise the dead.

It is a two-part program. The FSLIC will have to take care of the failed institutions. We hope forbearance will buy the time that it

doesn't have to take care of a larger number.

Mr. Bartlett. The purpose of forbearance is to work our way of the problems of the ones that can be worked out through recapitalization and to close down the others in an orderly manner. Mr. Turner, Mr. Nowlin, Mr. Roby and others, you all in some way react to what kind of mandate we should give to the Bank Board. I just want to pose this question to you. The Bank Board did, and I think the country as a whole is developing a consensus toward combining some kind of forbearance legislation with recapitalization.

If you were in our shoes, how much of a mandate, how specific would you be in our mandate to the Bank Board, in terms of regulatory reform? Would you do enough to be certain that we would know what the results are going to be, or would you just accept the Bank Board's proposal today and assume that the problems would be worked out? Mr. Gross?

Mr. Gross. I think the Congress needs to be specific. I think the Bank Board has good intentions. I think the proposals to date would be inadequate to solving the problem. And again, we are discussing the size of the losses, the size of the money needed. Again, I think with your forbearance proposals, the dollars needed will be far less, and without your forbearance proposals, I think that \$25

billion might not even be enough.

Mr. Turner. Mr. Bartlett, I think if we all put our list in, that list gets terribly encompassing. As you know, the U.S. League had a special committee that did list, and you incorporated several of those, in which there was a consensus in two or three areas—GAAP accounting, rescision of the R-41(c) appraisal, changed in classification of assets. I think you addressed the major problem areas. To get beyond that, then, I think we are back to square one of are you going to list all of them in some type of legislative proposal. And you will have to come back and address that at a later date.

Mr. Bartlett. My time has expired, but I will come back to it on the second round. But generally, you are saying, be specific, the Bank Board proposals didn't go far enough. We need only those items for which there is a genuine consensus that has developed. Thank you, Mr. Chairman.

Chairman St Germain. Mr. Vento.

Mr. Vento. Thank you, Mr. Chairman. The measures that are being considered before us on forbearance, attempt to define the area of an S&L located in an economically depressed region or that has a significant portion of its loans in such an area. For most of this, this term probably translates into some of the problem areas, such as the oil areas or the agricultural areas.

Do you think that—as an example, I am from Minnesota, or for instance, Iowa S&Ls—would that be eligible for such forbearance

under such a type of policy?

Is it your assumption that these areas are eligible or what? Yes. Mr. Rumbley. May I address that? I used some figures. Iowa has, at times, been capital-long, and we have been very active in the secondary market. So we have a major investment in the Texas area. We should be able to get the same kind of relief for our investment located in that area, as if we were domiciled there. Likewise, at other times, we have sold about an equal amount in Iowa, and Iowa is quite depressed for agricultural reasons. So somebody out there in a State or an area that may not be defined as economically depressed, are holding loans from Iowa that should be identified as economically depressed.

Mr. Vento. But this seems to suggest that there would be loans in such an area—in other words, it sounds as though they are going to define, by regulation, specific areas that have problems and other areas that don't. So I mean, it is going to be kind of difficult, I guess, to determine that, isn't it? In other words, it is going

to be left up to the regulator to define it.

Mr. Rumbley. When we were furnished information for this hearing, there were four different types of maps identified by four different criteria identifying States that could be considered economically depressed. So I am suggesting there probably are some

pretty good guidelines that could be developed.

Mr. VENTO. Those things are maps from the U.S. League of Savings. I appreciate their best guess at what this will do, but that doesn't necessarily satisfy, definitively, what the areas are. You know, the problem that I guess you get down to is, is it right, for instance to have basically a double standard? If you happen to have loans in these areas, and you are well-managed and you have problems or you happen not to have loans in these areas and you are well-managed, then you are going to treat a particular financial institution differently, and you have the same sort of net worth and the same sort of problems. Isn't that what we are getting down to?

Mr. Rumbley. It seems that a well-managed forbearance plan would benefit all S&Ls. It really wouldn't be a double system. The S&Ls that do not have investments in depressed areas, they would

benefit by having the FSLIC in place and the rates steady.

Mr. VENTO. I think there might be some tangential benefit, but the fact of the matter is, it is hard to benefit when you are out of business, when you are foreclosed upon, when you are merged, you are eliminated. Obviously, you are being treated substantially different than someone who happens to have an investment in Iowa farmland as opposed to someone that had an investment in some other activity-condominiums in Minneapolis or something-that didn't take out, which may be reasonable and prudent, and you may think it meets all the other tests. I am just trying to point what I think is the obvious that is not being discussed here today. If you can suggest that they are going to be able to split the hairs

on that, I would like to hear from them at this time.

Mr. Guidry. Mr. Chairmnan, if I may, I would like to mention something on that subject. As to my testimony, in having an equal distribution of distress throughout this country, through a personal experience of ours, when our Circuit 9 was discussing the restructuring of FSLIC. I would like to mention the restructuring of our Lafayette Building Association, which is an association that I

manage.

Three events happened in our restructuring area. We sold some-\$15 million worth of loans to help increase our earning position. That result led to a \$2 million amortization loss over the next 20 years. drainage on and because of poor management of institutions. cost our institution \$3 million over the last 4 years—well, it happened in 2 years really—because of excessive interest rates we had to pay to keep those poor-managed institutions afloat. And in reference to our insurance question, we spent \$280,000 last year in excess premiums to FSLIC.

Our concern in endorsing the League in small dollars rather than in the Treasury in large dollars is simply because we don't exactly know what our industry needs to get together and afford

some of those.

Mr. Vento. Let me just reclaim my time. I have one additional question. I understand—I want to give you some time to explain that, because I understand it impacts on you, and that is what you are here for. But the other question I have for your consideration, gentlemen, is, if we are successful—in other words, I am assuming that this forbearance language has some impact, and you keep these institutions, some 1100 institutions with less than 3 percent ratio of capital to assets, and some have zero—about half of them have less than zero, and many of those are nonprofitable, that we keep some of them in the marketplace, bidding for deposits. They are going to, in fact, bid up interest rates, in terms of that role. In other words, they have to be more successful than what our institutions have to be.

So I think the problem is, you've really got a double problem here. You've got the increased necessity, in terms of FSLIC funding with forbearance. Most of the savings and loan associations are asking for a smaller program with forbearance and, of course, with higher interest rates, very likely, in terms of bidding up those financial institutions that are impacted, there are more of them in the market, they are going to bid up the rates. And of course, with the possibility then of keeping in place higher assessments to pay for that, because the fund will need that. Either that, or it is going to have to eat up the borrowing that is occurring.

So you've got a multiplicity of problems that exist here, and I still don't think that the double standard issue has necessarily been answered. I am bothered by the geographic area. I am not bothered by forbearance, but I am bothered by the concern that someone is going to fall between the cracks, because I think that

the area issue is a parameter, and it does mean something.

Mr. TURNER. Mr. Vento, we've had that discriminatory thing before. This Congress granted the independent capital certificates.

Mr. Vento. My time has expired. I regret that, Mr. Turner.

Chairman ST GERMAIN. Mr. McCandless.

Mr. McCandless. Thank you, Mr. Chairman. Gentlemen, I would like to talk about the recapitalization aspect of our discussion, realizing that there has to be some direction in the forbearance area, but it is still an unknown quantity. We have a serious psychological problem that is beginning to generate. Mr. Hudson mentioned something about the way people feel out there in the hinterlands, that you need to have people on the spot. I would venture an opinion that about 435 of us will spend time in our districts and can correspond accordingly to who has problems. Hopefully, from time to time, we will find a solution. The point I am getting to is, that the public debt, both nationally and international, the solvency of our financial institutions and our financial system have become, in my district, of greater importance to the average person than what is going on in Central America, Europe or some other aspect of the

spectrum of congressional responsibility.

Now when we get to a recapitalization situation and we say, well, we can only use \$5 billion a year, so therefore, there is no point in going beyond that, but then there is an additional amount, either, say, in the ninth month or the thirteenth month, and maybe a little later on another five, and each time this takes place, there is a large wave that comes across the philosophy or psychology of the average investor that would not be there, if that original structure permitted this at a larger number, realizing the proposal by the Treasury Department says the instrument will only be sold when they are needed, and the assessment, if I understand it correctly, is not \$20 million today, that we will use over the next 4 years, 3 months or whatever it might be, but when actually needed. I find it difficult, in view of the psychology of the person out there, why the savings and loan people are saying, no, we don't like the treasury program, because they can only use so much per year, or it would be too costly in the long run. And I don't understand that, because you are only going to be selling these instruments as you need them.

So then one would say, well, is a low level of recapitalization actually a self-instituted forbearance that would permit institutions to continue to function that really should be looked at in another direction, with the idea in mind, it is costing, according to the Home Loan Bank Board, \$6 million a day against FSLIC, to keep a lot of these places open, if you don't get some kind of an alternative.

So now if anyone would like to answer, why is the Treasury Department's program flawed, if my understanding of it is correct, and we need to address that psychological problem of the people out there in our districts that write me and visit with me and phone me?

Mr. Gross.

Mr. Gross. Of course, our institution has not taken a position. We have no objection to the Treasury, as opposed to the U.S. League position. We just really feel, whichever is adopted, the forbearance is so critical, because that will probably greatly reduce

the total dollars that eventually get demanded under either program.

Mr. McCandless. Mr. Fogleman, you come from another part of the country. Is this, really, you think, an attempt on the part of the industry to build in forbearance, because they are not sure where

the Home Loan Bank Board is going to come down?

Mr. Fogleman. Yes, sir. As I stated in my testimony, I have felt for a long number of years that the group of five to seven people on a committee such as this makes a better decision than one or two people do. That has been my rationale. So many of these judgment calls need to be made by the Board or by the committee rather than a small group of one, two or three people, as we currently have, and I feel that the comfidence of the members in the industry would be significantly greater, if we were, in fact, dealing with a board of more than three people. In the refunding plan, for example, I think we would have had less aversion, and I do have aversion to funding more than can be used by those who are supposedly experts at such matters. They say only \$10 billion can be used over the next 2-year period of time.

Mr. McCandless. Do I think I think I am overreacting because of what people tell me about our financial institutions and what that might create in the way of a run on institutions who do not have

the money to pay people?

Mr. FOGLEMAN. Well, sir, I frankly do not see that there has been a shortage of funds in any particular thing. It is a perceived thing that there is a shortage of funds to be withdrawn. I think, in actuality, the two are not really the same thing in net worth.

Mr. McCandless. I meant a run on the bank because of a feeling that I had better get my money now, because it might not be there

later, irrespective of FSLIC, FDIC or whatever.

Mr. Fogleman. Sir, all I can, of course, give you is my opinion, which may not be very valuable, but I simply do not see that the public would perceive any difference between \$10 billion in available funds over 2 years or \$15 million or \$20 billion over 3 or 4 years. I don't see that that would have any difference in public perception.

Mr. McCandless. My time is up. Thank you.

Chairman St GERMAIN. Mr. Hubbard.

Mr. Hubbard. Thank you, Mr. Chairman.

You mentioned yesterday that on October 21 of last year House Speaker Jim Wright, the Majority Leader, and I met in Ft. Worth with very concerned S&L officials in the Ft. Worth/Dallas area.

This very morning I met with the savings and loan officials from Kentucky, and our Kentucky delegation met with about 20 of the S&L leaders.

At the October 21 meeting in Texas and again this morning, right here this morning in 2105 Rayburn, the S&L leaders have been expressing their concerns and even their distrust about the Federal Home Loan Bank Board.

They also had interesting comments in Texas on October 21 and again this morning about Mr. Edward Grey, Chairman of the Federal Home Loan Bank Board.

Would any of you gentlemen like to express your thoughts regarding the Federal Home Loan Bank Board and/or Chairman Grey at this time in this forum?

It is helpful information for members of the House Financial In-

stitutions Subcommittee.

Mr. Hubson. Mr. Hubbard, I think I told you on October 21 back in Ft. Worth, Texas that most of these institutions—I am talking about the savings and loan institutions themselves—are going to be reluctant to face the Gestapo, and I am speaking now of the Federal Home Loan Bank examiners.

What I am saying to you is that, yes, they are afraid. They are afraid of tactics that were just talked about here by Mr. Sullivan and by Mr. Darby of having their institutions overrun by examin-

ers the very next day.

They are going to be concerned with having all 41(c) appraisals done on all of their properties. That is a punishment, my friend.

That is the tool of punishment.

Now, they come in and they say to you, well, we have got to see about whether this is solvent. What they do is they send the examiner in, and he says we want our 41(c)'s on all these properties.

The cost is prohibitive. It is going to put you out of business. It is a self-fulfilling prophecy, and that is what you are up against, and that is why you are not going to get really direct answers out of savings and loan people.

Mr. Hubbard. Yesterday, when I asked Mr. Roy Green and Joseph Selby about the comments that were made in Ft. Worth,

they seemed shocked.

Mr. Hudson. I am sure they are shocked and surprised, as is the man who ran Treblinka. He is now caught.

I don't think there is any question about it. It is a discriminatory matter.

If you are in the business and you step up and you say, hey, I

don't like the action, they say get some more appraisers.

Mr. Hubbard. Who would like to follow the lead of Mr. Hudson? How about some others of you regarding your opinion about the Federal Home Loan Bank Board and/or Chairman Grey?

[No response.]

Mr. Hubbard. At the breakfast this morning it was mentioned that they opposed the Treasury plan. Some of the S&L folks from Kentucky said that they distrusted the Federal Home Loan Bank

Mr. Turner, what about you? What about this \$5 billion a year

that is questioned by the Treasury?

Undersecretary George Gould has said that. Do you agree with the statement of the Treasury, with Treasury Undersecretary Gould?

Mr. Turner. I think there is concern as to how the money would be spent, but I think that some of the concern has been moderated by what we view as the consideration by this committee of forbearance. Absent forbearance, then we are back to a money only solu-

So you have a question in how wisely is that money going to be spent.

I still think if you combine the two—I don't have the wisdom to tell you what that dollar amount might be. I know what the preference is, for a lesser amount, but events have changed, other things have changed that. I am not sure I am wanting to embrace \$15 billion at this point.

But, yes, there are concerns out there, and we have tried to draw

a consensus of everyone to support a program.

Mr. Hubbard. In closing, let me just say that this morning I discovered that some of my colleagues from Kentucky were assuming that the recapitalization plan for the Federal Savings and Loan Insurance Corporation was out of the Federal budget. I was surprised that they thought that, but some of them did, and they had been informed by the S&L people that, no, this did not come out of the Federal budget, this is not a taxpayer expense.

I assure you that perhaps there are some Members of the House and/or Senate from your respective States which might not know that this recapitalization plan would be not at taxpayer expense.

Thank you, gentlemen, for being with us. My time has expired.

Chairman ST GERMAIN. Mr. Parris? Mr. Parris. Thank you, Mr. Chairman.

The thread in the testimony of all you gentlemen is forbearance. I understand your desire for forbearance. I can see some justification in the major portions of credits are for home ownership, but commercial real estate, construction and acquisition and development costs are something else again.

There's all manner of speculation, condos, et cetera.

Is there anybody here that does not consider the extension of credits for commercial properties?

[No response.]

Mr. Parris. Apparently not.

Is there anybody here that disagrees with the statement that real estate and land values in your area have declined in the recent past?

[No response.]

Mr. Parris. Does anybody disagree that there's depressed security values, nonperforming loans, and an excess of current market values in many properties in your area?

[No response.]

Mr. Parris. Apparently not.

Mr. Roemer. Stan, would you yield?

I didn't hear your first question, Stan. Could you repeat it again? I am trying to keep up.

Mr. Parris. I will tell you later, Buddy. You got to pay attention.

We are going to have a quiz later.

Chairman ST GERMAIN. Stan, excuse me, but I think the panel didn't get it either.

Mr. ROEMER. You are just going through it too fast, man. Give it

a shot.

Mr. PARRIS. I apologize, gentlemen, if I, in my slow Virginia, Southern way, confused you, but I am trying to get some facts in the record.

Forbearance assumes that institutions will continue to operate until repossessed properties and bad loans regain sufficient value to return them to solvency.

Does everybody agree with that?

[No response.]

Mr. PARRIS. But would you also agree that rarely, if ever, will an already built building sell for more than the current cost of building a new comparable building?

The question is:

Why would anyone pay more for an older, used building than they would pay for a comparable new building to be constructed? Not now, Mr. Hudson, I don't have any time. I will get to you in

just a minute.

The recent tax bill is another question. It has lowered commercial property values, in my opinion, by something like around 25 percent in most areas of the country. We have got reduced tax benefits.

In addition to that, you have got to take the question of carrying costs, including interest, depreciation, maintenance expenses, utilities, and all the balance.

Those who believe the real estate market in their area will be

weak for the next 2 years, raise your hand.

[Show of hands.]

Mr. Parris. Almost everybody.

Those who believe rents will continue to be weak for the foreseeable future, raise your hand.

[Show of hands.]

Mr. Parris. Almost everybody. It is half, at least.

Now, let me give you an example of forbearance. If you have got a building that cost \$6 million—and you could add as many zeros behind all this as you want to—if the building cost \$6 million, the land is \$2 million, and it was built last year, when you add the carrying cost and all the rest of it, by the time you finish in 1992 you have spent 12,300,000 bucks.

You build a new building in 1992 under the assumptions that you gentlemen just agreed to, that same building will cost you 7,600,000 bucks, \$4.7 million difference, so that the existing building built in 1986 has \$4.7 million less value than the new building

built in 1992.

If you make those assumptions, now the only assumptions that would lead you to an optimistic conclusion on commercial forbearance is that you have a strong market recovery in 1987, which we can argue about, that you have all the excess done in 1990—if that happens in Houston, I will eat it, this report—that interest rates moderate, that operating incomes dramatically improve, you have just said you don't believe in any of that.

Now, if that is a correct assumption, gentlemen, then the scenario for the forbearance on commercial properties is too rosy a scenario for us to believe. It is not just FSLIC that insures depositors. Some would want FSLIC to insure investors, and that is not, in my

opinion, our first priority.

Now, I would be glad to yield to the gentleman from Louisiana to

propound a question. I apologize if I confused him.

Mr. Roemer. Thanks, Stan. I wondered about your first question that you led off with. You went through it too fast for me, and I think as slow as you talk——

Mr. PARRIS. The first question:

Would you disagree that real estate, and particularly commercial real estate, has experienced dramatic loss of value in the recent

past?

Now, just in regard to the League question, the question on the League plan versus the plan by the Treasury Department, Mr. Green of the Dallas Bank testified to us yesterday that in his responsible area, the five States around Dallas, basically, around Texas, it would require about \$8 billion of loans to solve the FSLIC problems there.

Does anybody here really believe that the League proposal for \$5

billion over 2 years would be adequate if that is correct?

When you have got ten other regions of the Nation, some of which, starting with California, others in Florida, are in almost, if not worse shape than is the depressed economy in Texas, does anybody really believe that the League plan would be adequate?

I understand your point, Mr. Fogleman, about periodic review, but apparently if you believe the President of the Dallas bank, he needs more money by 50 percent than the entire League proposal.

Chairman ST GERMAIN. The time of the gentleman has expired.

Mr. Parris. I am sorry.

Mr. Nowlin.

Mr. Nowlin. Excuse me. I believe Mr. Green's observation covered a period of 5 years.

Chairman St GERMAIN. That is correct, \$5 to \$8 billion over a 5-

vear period.

Mr. FOGLEMAN. And, Mr. Chairman, I believe that the proposal for the 2-year funding would not be \$5 billion, sir; it would be \$5 billion per year, including——

Chairman St GERMAIN. No, Mr. Parris is correct.

The time of the gentleman has expired.

Mr. McMillen.

Mr. McMillen. Thank you, Mr. Chairman.

I come from a State, Maryland, that has suffered dearly in the savings and loan crisis. A lot of people don't realize that it was the second in the last 25 years in Maryland, and if you were going to place an onus on why this occurred, certainly a good part of it would go on the savings and loan institutions and their self-dealing and speculative investments of some members.

But a good portion of it would go on the regulators, who were not watching the store. I guess it is the old chicken and egg situation,

which came first?

In your case in Texas, it is certainly compounded by a terribly

depressed economy.

My major concern is that the foundation is put in place, the regulatory framework is put in place to see that this doesn't happen again.

In Maryland, we not only recapitalized our State institutions, but

we also restructured our regulations.

You know, the old saying is don't throw good money after bad. I might say don't throw good money at bad banks and certainly don't throw good money at bad regulators.

Now, billions of dollars are in question right here that are being

asked for to replenish FSLIC. No doubt the money is needed.

The question I asked the Federal Home Loan Bank officials yesterday has to do with a Washington Post article and the independent Booz Allen study, which was not a thrift study or a GAO study, but an independent study, amid the most compelling issues here is really the lack of controls on the Federal Home Loan Bank.

My question to you specifically is—and this is for the record—if you were writing the legislation, the amendment to this recap legislation, specifically with regard to the Federal Home Loan Bank, what would be the three most important controls you would like to see in place, and what other changes would you put at the very top of your list with regard to the Federal Home Loan Bank?

I ask this of anybody—in particular, who can enlighten me on

this matter?

Mr. Hudson. Here I am again, Mr. McMillen.

It seems to me we need some independent person within the savings and loan structure that we can go sit down and talk to and negotiate with when we are the owner of an association, and we didn't go up there and face the institution, the Federal Home Loan Bank, and say, hey, we are going to support our supervisor and we are going to support these people and we are going to do whatever they ask you.

And you know you are going back to your association, and you

are going to be faced with some terrible, horrendous expenses.

The other thing is the education for those people and their techniques of supervision is terribly important. It has been alluded to here today.

And it is terribly important that they learn, that they very seldom have the gray hair, they haven't got any experience, and we don't pay for that experience.

Because we are going to have to pay for that experience.

If you are going to invest \$15, \$20, \$25 billion, you ought to have experience on that staff, people who have been there, who understand what the situation is.

And it is good to ask these questions about the old bill and go through the whole thing about what it is going to be worth in 1992.

The fact is, though, that they didn't give you one scenario, and that is most important in the real estate business, location, location, and location. There are locations where the old building is going to be worth ten times that.

And what I am saying to you is that in dealing with this, whether it be with the Treasury program or whether it be with the U.S. League program—and one is talking about the expense of the other—the real truth in what you are saying is—if I can characterize it—is that, man, don't give them too much because we don't trust them.

And I think that is what Mr. Hubbard was saying to you, and I think that is what we are trying to say to you. We don't trust them.

Mr. McMillen. One of the points you've obviously raised is the experience. And I think the Post might have editorialized a little bit, but it refers to saying that there was no uniform policy, we weren't reading off the same sheet of music. And that's a very, very important point as well.

I'd just like to clearly have in my own mind, you know, what are the major concerns that you have with regard to the regulators. And, clearly, those are two of them.

Any other thoughts?

Mr. Gross. Let me just say that it seems to me that you need a sizable enough Board that you can keep continuity. I think, for the last several years, one of the biggest problems we've had is there's always been a Board member missing, or somebody leaving or somebody coming. And very, very brief tours of duty.

I think, if you look beyond the Board members themselves, you will find a tremendously high turnover rate in the last couple of years. They're almost always key positions vacant, which are a

major concern.

I don't know if salary is a problem or what. Something really needs to be addressed in that area for the Board to function well.

Mr. McMillen. Just in conclusion, I wasn't here for all the testimony, but I presume that fiscal controls have to be a large part of this reporting and everything. I imagine those are the priorites, some sort of uniform policy, making sure the people there are experienced, having a sizable Board and really sound, independent auditing.

Does that pretty much address your concerns?

Mr. FOGLEMAN. Mr. McMillan, certainly. One of the comments that I made earlier, and I perhaps made at a time you were out of the room, I have a personal concern and I would like to add to the previous response about the size of the Federal Home Loan Bank Board.

To me, the best single thing you could do to control it, to control the wise expenditure of the dollars, would be to add to the size and continuity of the Board. They make judgment calls.

Mr. McMillen. What's the size of the Board right now?

Mr. FOGLEMAN. It's three, sir. And there have been a number of times during the past decade when the Board has been absolutely—it's been impossible for them to even take an action because they didn't have two members on the Board.

And the Board would be much more stable, and I think the in-

dustry much more stable.

Mr. McMillen. I appreciate your comments.

Chairman ST GERMAIN. I might say, over the past 26 years, that they've been short members on a very constant basis.

Mr. Barnard.

Mr. BARNARD. Gentlemen, I think, as you have probably discerned already, you're not going to satisfy everybody with whatever we do. We realize that.

Mr. Bartlett's bill, which was co-sponsored on the first day by myself, Mr. McCollum and Mrs. Oakar, on forbearance, was done

for the purpose of balancing this whole issue.

We felt that we had gotten the input of a savings and loan industry, especially that in Texas, Louisiana and other areas. Therefore, we felt like by combining these two bills, we have a balanced bill. Yes, we made a compromise there.

Are any of you all unwilling or are any of you willing to say that, yes, the combination of the Treasury plan, which was H.R. 27,

and the forbearance bill is a good, reasonable combination?

Or else, are you telling us this morning that we are still as unbalanced because we're giving them too much money?

Chairman St Germain. Even with forbearance?

Mr. Barnard. Even with forbearance.

So where do you come from? Help us a little bit, you know. We want to help you. We want to help the industry. We want to help the depositors in every savings and loan in the country.

So why don't we have a balanced conception here with the \$15 billion and forbearance, or else the \$2 billion or \$5 billion without

forbearance?

So, come on, somebody help us. Mr. Gross?

Mr. Gross. I think that you do have a very balanced position there. And I think it's one that we wholeheartedly endorse. I don't

think there's any question about that.

I think a good example of the benefit of forbearance is what Mr. Parris was citing. I would like to cite one that we have got in Houston. It cost \$44 a square foot to build an apartment and we're foreclosing on apartments that were built 4 and 5 years ago that

maybe only cost or only have a loan balance of \$18 to \$20.

Now I promise you, in 1992, it's going to cost \$50 to \$55 a square foot to build. You'll be able to get far more than \$18 a square foot for that apartment and you won't take a loss on it. That's where forbearance will be a tremendous asset. It will pull a lot of our chestnuts out of the fire; whereas, today, if you had to take that same apartment, you'd have trouble even getting \$18 a square foot for it.

Mr. BARNARD. Mr. Roby, how do you feel about it? You've been sitting there. I think you've been discriminated against because you've been the President of a Home Loan Bank Board. And they think you're a member of the Gestapo or something.

What do you think about it? Is this a balanced bill?

Mr. Roby. Yes, sir. In my testimony, I agreed with the forbearance.

Mr. BARNARD. And the Treasury bill?

Mr. Roby. I supported that when I was a bank president. I didn't fight against it. It's just that my personal preference was the U.S. League bill because of cash flow. But the cash flow in the first 2 years is approximately the same.

Mr. Barnard. Mr. Nowlin?

Mr. Nowlin. Mr. Barnard, I don't believe anyone has not been in favor of forbearance. And I think we will personally accept any kind of recapitalization plan.

Mr. Barnard. Mr. Fogleman?

Mr. FOGLEMAN. Sir, I testified in favor of forbearance and I testified in preference of the U.S. League plan for the reasons that I stated in terms of taking another look at it in a couple of years, and perhaps a restructuring of the Board.

But either plan would be approximately the same in the first 2

years.

Mr. BARNARD. One final question. Should we put a 5-year Sunset on this total bill? Then we can revisit it and revisit it from the standpoint of amount and forbearance?

Does anyone have an opinion on that?

[No response.]

Mr. BARNARD. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Wylie.

Mr. Wylie. Thank you, Mr. Chairman. I'd just like to follow up

on one of the questions Mr. Barnard posed.

You're all for forbearance and maybe I am, too. I'm not sure. I would say that I visited with some representatives of the Savings and Loan League last night, and they don't think that forbearance should be in this bill. Maybe it should be a separate issue because they're afraid that that might load it up too much.

But, to make my point, yesterday, Mr. Green presented several interesting case studies. Case A involved a \$2 billion institution with a negative net worth of \$400 million; Case B, an institution of

\$1.3 billion in assets, a negative net worth of \$350 million.

And I'm not trying to be argumentative here, I'm trying to get

some answers to this question.

Is it possible for an institution to get in a hole primarily as the result of regional economic problems and have those kinds of problems? And how do we separate out the two, if you see what I mean? Mr. Gross?

Mr. Gross. It's certainly easy enough for you to get in the hole without those kinds of problems. We're faced today, as I said at United, with having taken back over 100 houses a month for the last 6 months. We've got 85 percent of the properties we have fore-

closed are residential. Part of that is apartments.

But, even if you throw out the apartments, the 1 to 4 category has got to be 65 percent of everything we've taken back. It's not these wild, crazy loans that have gotten us into trouble. It's making—if we'd been making wild and crazy loans, we might have been all right—especially if we'd been doing it in some other part of the country.

But our problem is that we've done what we were supposed to do. But, when you're in the midst of a depression, it is really irrele-

vant.

Mr. Wylle. Thank you. Thank you, Mr. Chairman.

Chairman St GERMAIN. Mr. Roemer. Mr. ROEMER. Thank's, Mr. Chairman.

Tom McMillan, you were out of the room earlier when we talked about this restructuring business as to whether it should be part of the bill. I think everybody on our panel agrees there's some need for restructuring, but there was not uninimity as to whether it should be part of the bill.

In fact, Mr. Turner said it should not be part of the bill, but we

might want to work on a restructuring provision.

Let me ask Mr. Turner if I could: You made the statement, Mr. Turner, as to your concern as to how the money will be spent. And I wrote it down as you said it.

What do you mean by that? How could the money be misspent,

for example?

What concerns you specifically?

Mr. TURNER. I think it goes back a little bit to Mr. McMillan's question about the restructuring and the article that was in the Washington Post, as he referred to, we've gone through, as the chairman alluded, to having one and two board members over a

period of time. And that's not left us with great stability on the staff.

I think all of us at this table welcome any assistance that this committee would provide in terms of stabilizing the situation at the

Bank Board, and with the staff.

And if we can do that, and if this committee were to maintain proper oversight, and perhaps if we had an industry oversight group on the dollars, then perhaps you bird dog the dollars well

enough that they are well-spent where they are needed.

Mr. ROEMER. To me, there are a number of complicated issues that come in to one bill. I, like you, want to keep it lean and mean and to the point. But both Mr. Fogleman and Mr. Hudson have spoken directly to the issue of restructuring, continuity and credibility in the Federal Home Loan Bank Board system; that you are the one on the panel and the only one who said, although you were concerned about how the money was going to be spent, you wouldn't have restructuring part of the bill.

Now, it doesn't make sense to me.

Mr. TURNER. I want to qualify that. I support the restructuring of the Bank Board. I think we should have more than three. I think we should get it on a comparable pay and distinguished posture to the Federal Reserve Board.

My concern is exactly as you expressed: To have a lean, mean bill, the first priority is recapitalization. If you can restructure the Federal Home Loan Bank and crank a recap bill out of here in the

next month, I'll be glad to sign off on that.

Mr. ROEMER. The problem, Mr. Turner, is that no bill moves without an engine. The engine of this bill is the crisis in the industry. And that has to do with FSLIC recap. And we take this opportunity or we might lose it, not only this year, not only in this term, but in our lifetime.

Engines don't just come driving through here every day. If you get one, take a hard look at it. I hope you reexamine your position.

Mr. Turner. I did. I told you, if you can move that engine along with the restructuring, I'd love to have it right in there.

Mr. ROEMER. Thank you. Thank you, Mr. Chairman.

Chairman St GERMAIN. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman. I have precisely 5 minutes. Mr. Parris cited a series of questions which would lead one to the conclusion—I don't think an invalid conclusion—that the economy's in pretty tough shape.

And, in many institutions as a result of the economy and other

things, they're in rough shape.

I think the conclusion I would ask of you, and I'm going to use one example, is it seems to me that the conclusion ought to be that we should at least stop doing those things through regulatory practices which drive down net worths and make things worse than they really are.

I want to call the committee's attention to a case example number one that was used by Mr. Turner, and then I want to ask

you:

Is your judgment based on the last 12 months of just one area of forbearance or regulatory reform? Which is the appraisal process. Is this a typical way that, in fact, the regulations are stated and

they're in effect in this particular institution? It was a condominium?

And the condominium was directed to secure an R-4lC appraisal even though the property was 85 percent leased and had a positive cash flow.

That appraisal resulted in a substantial writedown of the property and the appraisal used, as I read that one—I'm sorry. The appraisal used on this one and another one in an earlier example used a 14.5 percent capitalization rate.

Now, as you go through our 4lC appraisals in which you have properties that there's cash flowing, is it the typical appraisal that

results in a cap rate that is that size?

And what's the result of that, even though you may have a well-managed property?

Mr. Gross?

Mr. Gross. We've got that very situation. We ended up spending a million dollars last year on appraisals in conjunction with our exam and had probably \$15 to \$20 million worth of appraisal write-offs as a result of it.

And, again, we did have the situation where the return on equity said 14.5 percent and the return on a loan or on the cost of funds

should be 11.5.

The net result of that is it takes an appraisal of, say, \$5 million, and it was appraised at \$3.5 million. So I took a project of one of

the S&L's in Houston and it collapsed.

Mr. Bartlett. Let me just ask you, if your accountants were valuing that property, or if you were valuing that property just based on a market value but not on a distress sale, but a fair market value—willing buyer/willing seller—would you use a 14.5 percent return?

Is there anybody here that would believe that's a realistic result?

Mr. Gross. Eight percent, 9 percent is a reasonable return.

Mr. BARTLETT. And your auditors and your accountants would have you use that return, 8 or 9 percent return? Is that what you're saying?

Mr. Gross. Yes, sir.

Mr. Bartlett. Is it your testimony that when a majority—somebody testified—does everybody else find this the case, that the majority of your nonresidential real estate loans re ordered to be reappraised, whether they're performing or not?

Mr. Gross. That's correct.

Mr. Bartlett. Is it less than a majority in terms of the standard practice of economically depressed real estate? What you're trying to say to this committee is, in many specific cases, we can call it forbearance—the regulations themselves contribute to driving down the losses much lower where we suffer losses much larger than what the real losses are.

Mr. Gross, you've said it, and others of you, the real losses are bad enough. It's tough enough to keep a property cash flowing. Are those appraisals ordered whether or not the loan is performing and

whether or not there's cash flow?

Mr. Gross. Yes. If the loan is over a certain size in conjunction with the exam, you have to get the appraisal regardless of whether it's performing or not performing.

Mr. Bartlett. Let me ask Mr. Sullivan, because he is a borrower. If that one feature itself would change, would that, in your opinion, help to cause lenders from the rest of the country to once again begin making bona fide legitimate loans into a depressed market. Is that one of the features that is keeping—we call it redlining, but is it preventing lenders from loaning into the Texas market and elsewhere, because it is driving down the appraisals?

Mr. Sullivan. I believe so, but also properties are being driven down because there is no available mortgage money to buy or sell

these properties.

One comment I would make to Congressman Parris' example of the \$2 million land cost and a \$6 million building cost. It is not for us to consider the replacement costs in 1992 versus that cost today. It is, what will that building sell for today on the auction? Maybe \$5 million? Then the difference can really be brought together by 1992.

Mr. Bartlett. So, in summary, what I have heard the witnesses here today say is that combined with recapitalization, ought to be a more accurrate valuation of the current real estate market, which then permits much property to be worked out, and most, but not all, institutions to work their way back into profitability.

I thank the witnesses and Mr. Chairman for the extra time.

Chairman St Germain. Mr. Carper.

Mr. Carper. Thank you, Mr. Chairman. Gentlemen, I want to thank you for your testimony. Most of my colleagues here serve on several subcommittees, and, unfortunately, two other of those have been in hearings this morning and early this afternon, and I apologize for missing your testimony. I will have the opportunity to review it later, but let me just ask a broad general question. I think it has been asked in one way, but I am not sure I understood the answers.

What I am looking for is where you all agree, those areas where you all generally agree in policy, in the kind of policy decisions that we have to make here in the next couple of weeks.

Do each of you support the proposal, the recapitalization proposal put forward by the U.S. League? If not, do any of you disagree with it?

Mr. Gross. We are in favor of H.R. 27.

Mr. CARPER. OK. How about the other members of the panel? Who supports H.R. 27, the approach in the bill?

[A show of hands.]

Mr. CARPER. Who does not?

Chairman ST GERMAIN. They testified that most of them prefer the U.S. League proposal; however, if that is not the case, they support H.R. 27.

Mr. CARPER. Fine. Those of you who support the U.S. League,

would you just raise your hands.

[A show of hands.]

Mr. Carper. My understanding of the U.S. League proposal is a \$5 billion recapitalization. We had the GAO come before us this week to indicate that there is, what, \$6 billion in losses that have yet to be incurred or accounted for. That \$6 billion would essentially wipe out most of that \$5 billion that we are talking about. How can the \$5 billion be enough?

Mr. Guidry. That is true, as far as the figures, but I have heard many other figures. That complicates my opinion as to the number of dollars that would be necessary, possibly we are looking at more dollars, but in the immediate future, I am looking at the U.S. League dollarwise program, in order to get us started. My feeling is that by committing a substantially larger amount of dollars without the knowledge of what the industry and FSLIC can do, would be rather dangerous, unless we are uncommitted, to draw these funds as they are needed. If it is so, then I would support either one. I think the priorities here are not necessarily the number of dollars. We must get through the fact that we need some dollars. FSLIC needs to be recapped.

The Board, after listening to the testimony, I feel, too, has to be restructured, in order to help us have the forbearance issue resolved, so that the associations themselves that are still in good standing around this country can operate and earn part of the responsibilities that they already have in funding some of those dollars to FSLIC by permitting them to work with our loan people.

Mr. CARPER. Somebody else had raised their hand indicating that you support the U.S. League proposal. Again, try to respond, if you will, to my question. The GAO says there is \$6 billion or \$6.5 billion out there that has yet to be realized as losses. As soon as that takes place, it wipes out the \$5 billion in the League proposal and puts us back in the same predicant that we thought were were in all along.

Mr. Fogleman. May I respond?

Mr. CARPER. Please.

Mr. Fogleman. Sir, I believe that 27 covers a 4-year period of time and during that 4 years includes approximately \$10 billion to \$15 billion in funding, whereas the U.S. League plan covers only 2 years, and over that 2-year period covered \$5 billion in funding, additional funding. In addition to both of those figures, the annual income with the special assessment of the FSLIC is about \$2.5 billion a year. So under either plan, we will have approximately \$5 billion during the first year. Whichever plan you use, the U.S. League plan or the Treasury plan will have \$5 billion a year for the first 2 years. We are simply saying that we can't quantify the loss past the 2-year period of time. We are saying also that we can't successfully and wisely utilize in excess of \$5 billion a year.

During the past 2 years FSLIC has utilized \$6 billion in 2 years, sir, there will be available here \$5 billion a year for each of 2 years

with bonding and the \$2.5 billion a year income.

Mr. Carper. My time has expired. Thank you for your responses to those questions.

Chairman St Germain. Mr. Parris.

Mr. PARRIS. Thank you, Mr. Chairman. Let me say, when my time expired earlier, Mr. Green testified, Mr. Fogleman, that if you cut off the problem right now and solved the problem at the Dallas

bank, it would cost \$5 million right now.

This is a national Congress, gentlemen. We understand the economy and the energy and agricultural areas of the Nation are depressed. All of us would like to be compassionate human beings. It seems to me the hard question in this whole issue is, why should the rest of the thrift industry or the taxpayers of Virginia or the

balance of the Nation ultimately pay to solve your problems? From their point of view, my constituents, isn't it better to accomplish what I call "severability" of the sick institutions and to cut the tax-payers' losses right now? Now that is a hard question. Mr. Vogleman said he was concerned that the money be spent wisely. I agree with that. Fundamental to the issue here, gentlemen, is, if you give the Federal Home Loan Bank Board another \$25 billion, if you like what they did with the last \$20 billion, you will love what they are going to do with this \$25 billion. That is fundamental to the issue.

Can we regulate your industry, the marketplace in this Nation today? Have you, through innovative market transactions, security-backed mortgages and financing? All the changes in the industry that you know so much about, can you overrun the ability of the

regulators to control it?

I submit that maybe you have and maybe you have abandoned, in your own way, the dual banking system. But that is another

issue for another time.

Mr. Hudson, Mr. Sullivan said, I didn't take into account the value of the building. That is true. This is a very complex problem, Mr. Sullivan. Have you ever tried to summarize "War and Peace" in 5 minutes? Mr. Hudson said the location of the building could be worth ten times that much. Location; right? Time magazine says on their article on the commercial building in Houston, that it will take until 1995 to occupy. Now that is the location that put 49 percent of the savings and loan institutions in the State of Texas in an inadequate or insolvent, inadequate capital or insolvent category. That location is not my idea of where I want security for my depositors, and I am sorry about that, but it is called the facts of life in the real, hard world.

I just have one question of you gentlemen. I have sat here for 3 hours now, 4 hours. I assume that you all would support GAAP. GAAP is, in my opinion, equivalent to government-sponsored fraud. I have said that before, and I hope that this bill will contain a GAAP provision. You and I think support the elimination. If anybody has any violent objections to what I am saying, they can jump

up and down.

I assume that you would like to have the loan recognition restructured work out provisions under the financial accounting standards for Rule 15. I assume you would like a GAAP general reserve account, not charged against net worth. I assume you like to go to the general accounting principles that will let you operate your business in a legitimate way without somebody from some regulatory bureaucracy coming in there and having, as Mr. Gross has indicated, a \$20 million hit because of some appraisals in which there are not standards with a definition of what an appraiser is.

Does anybody disagree with any of that?

[No response.]

Mr. Parris. I thank you very much.

Chairman ST GERMAIN. Gentlemen, the Chair wishes to express his appreciation to you for your persistence today. We may have some additional questions to submit to you in writing, and I hope you can help us out with a response.

The subcommittee stands in recess, subject to call of the Chair.

[Whereupon, at 1:55 p.m., the hearing was adjourned.]

APPENDIX

Testimony of Mr. Wade T. Nowlin
Chairman of the Board and Chief Executive Officer
of Nowlin Savings Association and Nowlin Mortgage Company,
Fort Worth, TX
Before the

Subcommittee on Financial Institutiona Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affsira

MR. CHAIRMAN AND DISTINGUISHED MEMBERS OF THE COMMITTEE:

My name is Wade Nowlin. I am Chairman of the Board and Chief Executive Officer of Nowlin Savings Association and Nowlin Mortgage Company, Fort Worth, Texas. I am accompanied by Mr. H. Robert Frenzel, President and Managing Officer of Nowlin Savings Association.

We are pleased to be here today and appreciate your invitation to appear before this Committee to share our views on the provisions of H.R.27, H.R.1063 and other related issues.

The continuing drain on the FSLIC fund is well documented. The situation has reached the point that positive action <u>must</u> be taken to adequately recapitalize the fund. Regulators dealing with insolvent institutions are not able to take appropriate actions and these delays appear to be leading to increased costs to the insurance fund and a decrease in public confidence. Recapitalization in some form must happen soon.

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However, this recapitalization must be accompanied by forbearance measures and reasonable regulations that allow viable, well-managed institutions a means to work through their problems, build their capital bases, and therefore strengthen the FSLIC fund rather than submit it to additional risk.

We support forbearance measures only for well-managed thrifts operating within the regulations whose troubles are the result of operating in an economically depressed region and not due to fraud, imprudent operating practices, speculative ventures, self-dealing, and excessive dividends and life-styles.

The following forbearance measures should be made regulations administered by the Federal Home Loan Bank Board.

First, Statement of Financial Accounting Standards No. 15 (FASB 15) should be specifically authorized in the regulations. FASB 15 allows a problem loan to remain on a thrift's books without writedown provided the loan is restructured so that it is probable that the borrower can repay the loan under the new terms and the lender will receive cash payments totaling at least the loan value.

It should be emphasized that FASB 15 is generally accepted accounting principle but is not a cure-all because this rule will not normally apply to loans on raw land or projects without cash

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flow. In addition, provided the association's independent certified public accountant rules FASB 15 has been properly applied, such loans should be exempted from the asset classification regulations.

Second, if a loan originated or purchased prior to January 1, 1987, is foreclosed and the real estate is taken back, any loss due to a writedown of the asset to the current fair market value should be allowed to be amortized over a period of 5 to 10 years. This would allow an association both the time to work with the real estate and give the market cycle the opportunity to fully evolve to bring the asset to its maximum value.

Third, the Capital Forbearance Policy as outlined by the Federal Home Loan Bank Board on February 26, 1987, should become regulation rather than simply policy to insure the public confidence that savings and loans operating under such provisions will be allowed to carry out their plan.

Coupled with forbearance, certain regulations currently in effect exacerbate the situation and should be rescinded.

Section 563.17-2 of the FSLIC Insurance Regulations requires an "R41" appraisal at the time real estate is acquired through foreclosure and further requires a writedown if the appraisal is less than book value. Instead, we believe at foreclosure,

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generally accepted accounting principles should be applied requiring a determination of current fair market value which would involve considering numerous factors. In the event a writedown were required through this process, as noted previously, we support the concept of amortizing that loss over 5 to 10 years.

Section 563.13(b) of the FSLIC Insurance Regulations requires additional regulatory capital equal to 20% of the amount invested in real estate acquired by foreclosure. If an asset acquired through foreclosure is carried at current fair market value by an institution, there is no reason or logic in requiring additional net worth. An asset carried at fair market value regardless of how it was obtained, does not carry additional risk that should require additional capital. This "double hit" concept of writing an asset down and then requiring additional capital for the remaining current fair market value is unnecessary, punitive, and should be abolished.

A final concern we have for the continued viability of the savings and loan industry is the integrity of the ownership and management of insured institutions. Far too many examples are on record of fraud, self dealing, insider abuse, speculative or imprudent ventures, excessive operating expenses, excessive officers and stockholder compensation and extravagant life styles, and tremendous growth fueled by high rate and often brokered deposits.

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Using due process and individual judgment at all times, the regulatory authorities must move swiftly and forcefully against this element in our business. Neither the FSLIC nor the legitimate, well-managed thrift institutions should be required to pay for the excesses of those managements not willing to play by the rules.

Mr. Chairman, I again want to thank you for inviting us to present our views on these important issues. And we appreciate the Committees' consideration of our point of view.

STATEMENT OF

MR. JENARD M. GROSS,

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

UNITED SAVINGS ASSOCIATION OF TEXAS

Before

the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

of the

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

March 4, 1987

Good morning Mr. Chairman, and members of the Committee. My name is Jenard M. Gross, and I am Chairman of the Board and President of United Savings Association of Texas.

I appreciate very much the invitation to share some of my thoughts with you on a topic which has been much on my mind. I believe there are very few responsible officials of financial institutions today who do not recognize the need to immediately recapitalize the Federal Savings and Loan Insurance Corporation ("FSLIC"). The program reported out favorably by the Committee, passed by the House last year, and reintroduced as H.R. 27 is sound and will, together with the provisions I will discuss today, accomplish its purpose. I fully support H.R. 27 and urge immediate action on this important legislation.

I would like to focus my remarks today on an area which, as I see it, should be viewed as part of the FSLIC recapitalization and should, but as yet does not, enjoy the same widespread support. Although, the term "forbearance" is often used to refer to the concept I will be discussing, I think it is more accurately described as "regulatory realism." I would like to put my remarks in context by describing our situation at United Savings.

United Savings is the largest savings and loan association in Texas, with assets in excess of \$6 billion. Approximately 26% of our assets are invested in loans, and an additional 42% are invested in mortgage-backed securities. The remainder of our assets are primarily liquidity and other debt and equity securities, and real estate. Approximately 70% of our loan portfolio consists of mortgages on single family dwellings and 8% is in loans secured by multi-family units. Consumer and commercial loans comprise approximately 7% and 6% respectively of our loans, and approximately 9% of our loans, or slightly under 4% of our assets, are non-residential real estate loans. Taken together, our single family loan and mortgage-backed securities portfolios currently represent approximately 65% to 70% of our total assets.

In 1986, United reported a net loss for the year of approximately \$36 million. Had we been subject to the Farm Credit Bank Rules, making loans to certain agricultural users, United would have reported, on the same operations, a profit of approximately \$48 million. Similarly, had we been able to move all of our Houston real estate to Mexico and been making loans to an LDC, our profit would have been in excess of \$60 million. The difference is not one of operations or management; it is merely the difference of a congressional and regulatory response to a depressed economic situation that has already been implemented for financial institutions serving farmers and lesser developed

countries. I believe similar treatment must be implemented for financial institutions serving the equally depressed areas of Texas, the Southwest and, in fact, the whole heartland of this country.

As Roy Green, our Principal Supervisory Agent and the President of the Federal Home Loan Bank of Dallas has pointed out, in eight of the twelve Federal Home Loan Bank Districts, the total savings and loan industry maintained a positive return on assets. In all others, save one, the negative return was less than 1/2 of 1%. Only in District 9, covering Texas, Oklahoma, Louisiana, Arkansas and New Mexico, was there a significant negative return on assets, a whopping 3%.

The vast majority of United's loan activity has been in Texas. As a result of the depressed local economy, our loan delinquencies recently have been considerably higher than we would like. In dollar value, approximately 52% of the delinquencies are single family home loans, 4% are consumer loans. Although our portfolio is diversified, one can readily see from these statistics that a large portion of our investments, and of our problem loans, are in residential mortgages.

While the category of single family home mortgages typically is the most stable and dependable nationwide -- reflecting the traditional commitment of Americans to home ownership -- at United, this is our largest category of delinquencies. Due to the cyclical nature of the real estate, agricultural and energy markets, in which many of our borrowers were employed and on which the Texas economy is based, homes are now abandoned or at risk. In real terms, this means that United is foreclosing on over 100 homes a month. Since 1984, over 3,000 families holding mortgages from United have been unable to make payments and thereby have lost or may lose their homes. In Houston, S&L's foreclosed over 16,000 homes in 1985; 25,000 in 1986; and 3,000 in January 1987. The people being forced from their homes are not "deadbeats" or speculators; they are simply families trying to survive an extended period of unemployment caused by forces beyond their control. Business borrowers have been adversely affected in similar fashion with similar, or more extreme, results. We are in the throes of a depression that begain in 1982 and cost 150,000 jobs in 1982-83 and over 35,000 jobs in 1986. In Houston today there are over 115,000 vacant apartments and 36 million square feet of vacant office space.

Eventually, however, oil and gas prices will firm up; farmers will receive higher prices for their produce; Texans will be employed; mortgages will be paid; and land values will increase commensurately and the depression in Texas will be over. But recovery is still some period away. In the meantime, it is necessary to manage the chaos and minimize the dislocation, pain and suffering that is necessarily attendant with economic recession and regional depression.

As in any human endeavor, the management of thrift institutions varies greatly in quality, ability and, if you will, talent. Certainly I will not, and I doubt anyone will, tell this Committee that there have not been losses due to mismanaged thrifts and speculation. However, I am personally convinced that by far the largest percentage of the loan losses being experienced by S&Ls in Texas do not stem from such factors. If the management of every ailing S&L in an energy or farm market were replaced today by Angels with extensive S&L experience who could miraculously cure all the problems caused by mismanagement, there would still be a need for a policy of flexibility and forbearance for the next several years on the part of the thrift regulators due to extraneous economic factors.

It is significant to note that over 35% of the houses on which United is foreclosing were built prior to 1981 and, therefore, are properties in which borrowers would normally have built up equity. In addition, many of the apartment complex loans being brought to our Workout Committee date back as far as 1969 with loan balances of \$4, \$5, and \$6 per square foot. When such loans will not service existing debt because of the

combination of high vacancies and increased operating costs, the magnitude of the economic depression in the Southwest is readily apparent.

But it is not sensible to say that these properties are worthless just because they are not now servicing their debt or operating expenses. They may not have great value today but, given a period of time, they will come back. Look at some examples: in 1976, New York property was being foreclosed at absurd rates, today those same properties are pure gold. Detroit, houses were being given away in 1982; today there is a four to six month backlog for buying new houses. Similarly, we all talked about deindustrialization of New England and the disastrous demise of Boston area in the mid-1970's. Today, New England and Boston are the hottest growth markets for industrial jobs and for real estate values in the country. We are in a regional and cyclical depression but we are nearing the bottom of it. With some assistance we can ride this depression out, get over the hump and into a situation where we can again be profitable.

It would be a grave tragedy and disservice to this nation for the regulators of the thrift industry and Congress not to recognize and adjust for this massive, yet temporary, phenomenon.

If all thrifts mark down their loans to "market" (as the Bank Board defines that term) at the time of foreclosure, every financial institution in the Southwest will probably become insolvent within just a few years. On the other hand, implementation of realistic forbearance policies can prevent this result. This will not be the first time there has been a forbearance solution for a particularly devastating regional economic problem. The near-bankruptcy of New York City did not require the New York banks to write down their New York bonds to market. If that had been required, many of the New York City banks would have been insolvent. Similarly, when the Farm Credit Bank crisis arose last year it was decided that these banks could write off their losses on real estate over a 20 year period of time. As I noted at the outset of my remarks, had United had the same opportunity in 1986, instead of showing a \$36 million dollar loss, we would have had a \$50-60 million dollar profit. Moreover, if, through some act of God we had been able to float our real estate collateral south by only 350 miles to the other side of the Mexican border we could have advanced the interest payments to the borrowers, and all of our real estate loans would have been considered "current". The interest would have been considered a loan and everything would have been wonderful. This, in essence, is the cornerstone of the handling by major commercial banks of their loans to lesser developed countries. Yet the actual prospects for repayment are, I submit, much better

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for the loans secured by Houston real estate than for many loans to Brazil, Peru or Argentina. All we are asking for is a level playing field.

I note that the Bank Board has within the past week announced a recognition of some of these problems, and we at United applaud their efforts. But, I believe that we need to go further. The new policy deals only with institutions falling below minimum regulatory net worth, whereas the LDC and Farm Credit response addressed the problem of an across-the-board basis.

I would therefore like to turn briefly to the elements of forbearance and flexibility which I believe are essential and to suggest a few technical regulatory changes which could be quickly implemented. Combined, these actions would go a long way toward relieving the crisis in the thrift industry caused in my area of the country by the depression in the agricultural, energy and real estate sectors of the economy without unduly burdening our financial system or allowing dishonest or weak management to avoid detection.

FORBEARANCE MECHANISMS

I believe it is vital that savings institutions serving depressed local economies receive adequate immediate assistance in the form of specific regulatory forbearance. I have three suggestions for the form this forbearance could take.

Loan Classification Moratorium.

The first form of forbearance would be to institute a moratorium on loan classifications on the basis of a decline in the value of real estate collateral located in designated geographic areas most hard-hit by the depression in the energy and agricultural sectors. Such a program would be modeled after the approach followed by the commercial bank regulators in requiring classification of international loans to lesser developed countries ("LDCs"). See 12 C.F.R. § 211.43. Under the commercial bank program, banks are not required to recognize losses on loans to LDCs unless and until the LDC has been appropriately designated by joint action of the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. The program for thrifts could be operated in a similar, though converse, fashion. Certain depressed geographic areas could be pre-designated by legislation. Regulatory loan classifications based on general depreciation in real estate values in those areas would be

precluded until regulators had determined, after appropriate hearings and investigation, that real estate values in those areas were no longer depressed as a result of stagnation in national, regional or local energy or agricultural economies.

Alternatively, the Bank Board could adopt a policy similar to the policy of the Farm Credit Bank which allowed a 20-year period to write down problem loans. Such a policy would establish a 15-20 year period for writing off a loan the loss on which resulted from the decline in the energy or agricultural sectors.

This approach would provide the flexibility necessary to avoid the "fire sale" valuations now prevalent in characterising the quality of thrift portfolios. It would also provide regulators the flexibility to remove specific areas from the "distressed" categorization on an area-by-area basis without the necessity of Congressional action or a finding that the overall agricultural or energy sectors had fully recovered.

It is instructive to note that while Texas banks enjoyed a lower cost of funds in 1981 than the New York City banks by about 12 1/2 basis points, today, on six month jumbo CD's, the New York banks can acquire funds for about 60 basis points less than Texas banks. On regular six month deposits, there is almost a 70 basis point spread. The reason for this is the perceived higher credit

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risk of the Texas banks compared to the New York banks. The reason for the perceived credit risk is, I believe, a direct result of the different treatment accorded petroleum and real estate loans in the Southwest compared to loans to LDC's. If the New York City banks had to mark-to-market their Brazilian loans (that have now suspended even interest payments), their Mexican loans (which have been reworked and reworked), their Argentinian loans and all of their other third world loans a number of them would probably have limited, if any, net worth today. I think it is illustrative and useful to note that the German banks (which have been required to recognize the problems with these loans) have written off approximately 45% of their loans to Mexico while the New York banks have written off virtually none.

While I realize that the LDC situation is a political problem involving more than bank repayments, the truth of the matter is that if the S&L industry had a level playing field and the New York LDC loans were treated the same as the loans in Texas, the interest rate differential today would not be in favor of the New York banks. The effect would be to eliminate the differential in rates for New York and Texas banks.

Formal Forbearance Policy.

The second form of assistance would be the adoption of a capital forbearance policy for thrift institutions patterned closely on the forbearance policy adopted last year by the federal banking agencies. See 51 Fed. Reg. 15305 (Apr. 23, 1986) ("Bank Policy"). The Bank Policy recognizes that, in times of economic depression in certain sectors, it is vital that lending institutions continue to service those economic sectors that are still vital and which can form the basis of recovery for the institutions involved as well as other depressed sectors. Briefly, the Bank Policy is to forego regulatory action against a bank whose primary capital ratio falls below a specified level so long as that decline is caused by the depression in the agricultural and energy sectors and not by mismanagement, fraud, speculation or other such reasons. In addition, the bank regulators will allow a bank, in spite of its impaired capital, to continue to make loans to solvent borrowers in order to provide capital to thriving economic sectors and to rebuild the bank's capital.

In contrast, the Bank Board has recently doubled its basic capital requirements for S&Ls, to be phased in starting immediately. This action, when coupled with the actions relating to required reappraisals and revaluation of assets, is in stark contrast to the more realistic approach of the bank regulators

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and could well lead to unfair and anomalous results. I, for one, fail to see the logic in a regulatory system which allows the bank which has financed the operations of an independent oil driller in Houston to remain open despite delinquencies in the loans extended, while the savings and loan which has made a mortgage on the oil driller's home is closed because payments on his home mortgage are missed and the value of the home has declined.

For this reason, I was encouraged by the Bank Board's announcement late last week of a forbearance policy similar to that in effect for commercial banks in the energy and agricultural sectors. However, I believe the Board's new policy can only be effective if it is coupled with the type of reprieve from appraisal-based loan write-downs I have discussed above. Simply put, the magnitude of reserves which may be required based on depressed real estate collateral values is such that a large number of thrifts would be unable to meet the 1/2 of 1% capital standard set forth in the forbearance policy. Furthermore, the requirement that thrifts seeking to be covered by the policy demonstrate a program to restore their capital levels independent of any restoration of collateral to normal values will simply be unrealistic in many cases.

In addition, I think that the applicability of that portion of the Bank Board's revised capital regulation which increases the basic required capital ratio from 3% to 6% should be postponed with respect to thrifts in depressed areas. Thrifts suffering from declines in the energy or agricultural sectors they serve should not be required to meet increased capital standards, particularly when those standards were put into effect after the economic distress afflicting those sectors had already come into existence.

Loan Assistance Policy.

The third means by which Congress could provide temporary but immediate assistance to thrifts serving economically depressed areas is once again premised upon the belief that any acute slump in real values, such as that presently affecting Texas, is temporary and that such values will recover in, at most, 5 to 10 years. The assistance I propose would consist of the transfer of a non-performing loan or non-earning real estate owned ("REO") to the FSLIC or other appropriate federal government entity in exchange for a long-term non-interest bearing note equal to the book value of the loan or real estate transferred. The FSLIC would hold the transferred asset for the period of economic recovery, at which time FSLIC either disposes of the collateral (which should then be worth the value at which it was put on the FSLIC's books), or the institution would

reacquire it in exchange for the FSLIC note. The institution would continue to service the loan or REO in either case so that no increase in FSLIC staff would be required.

This approach would have the advantage of requiring no cash outlays by the FSLIC but would effectively "warehouse" non-performing loans or REO so that large write-downs would not be required on the books of the institutions involved during the period of economic recovery. Disruptions in local real estate markets caused by the "dumping" of assets of insolvent institutions would be avoided. As I see it, this is the least costly approach to bridge the period between now and the time when the energy and agricultural sectors rebound economically.

As an alternative to the above proposal, the net worth certificate ("NWC") program first authorized by Congress in 1982 could be reinstituted and modified to cover losses generated as a result of the revaluation of REO or loans secured by property in specified depressed areas. As under the NWC program, the FSLIC would purchase NWCs from the institution in exchange for FSLIC notes. The NWCs would be redeemed when institution's local economy improved sufficiently that reserves with respect to its assets were no longer required, and its capital was therefore adequate to support repayment.

I note that H.R. 1063 recently introduced by Rep. Bartlett requires the Bank Board to undertake a study to determine the feasibility of a warehouse facility. I would like to take this opportunity to extend my heartfelt thanks to Congressman Bartlett and others for their efforts to bring the need for a forbearance policy centerstage and for introducing legislation that goes a long way to meet the needs of thrift institutions located in economically depressed regions. In many respects, the foregoing proposals on my part track provisions in H.R. 1063. In particular, the loan purchase or extended net worth certificate programs I have discussed are options for the operation of a facility of the type that H.R. 1063 proposes be studied. I would urge that the Committee move immediately toward the establishment of such a facility, or limit to 90 days the time the Bank Board has to study such proposal and mandate implementation of a facility within a fixed time thereafter. It would appear that an existing institution, the Federal Asset Disposition Association, is already established which could fulfill this function. demonstration of need is with us daily. The longer the solution is delayed, the harder and more expensive the solution will become.

APPRAISALS

In addition to the programs addressed above, I would like to suggest certain methods by which the Bank Board could immediately improve the environment for thrifts serving economically depressed regions. An example of an easily implemented regulatory change which would have a dramatically positive effect on the solvency of many Texas S&Ls is a lessening of the frequency and stringency of the revaluation of assets and collateral required by the Federal Home Loan Bank Board. The Bank Board's regulations provide that collateral securing a loan must be reappraised in connection with a foreclosure. In addition, an examiner may order reappraisals of thrift assets as frequently as "advisable or necessary." I believe there are two fundamental problems with the current approach the Bank Board follows with respect to reappraisals.

The first is that reappraisals are required much more frequently than is "advisable or necessary." I think it is safe to say that reappraisals are ordered with respect to the vast majority of non-residential real estate loans experiencing any sort of performance difficulty, whether or not close to foreclosure. Often reappraisals are ordered on fully performing loans. This in turn imposes an undue burden on, and generates needless expense for the institution involved. The reappraisal process is no small matter. Under Bank Board regulations and

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Memorandum # R 41c, the thrift must pay for any appraisal, and the appraiser must use "All recognized appraisal methods and techniques," rather than just that technique the appraiser believes will most accurately produce the market value of the property. In essence, this requires the appraiser to conduct, and the thrift to pay for, as many different appraisals of the same asset as there are recognized appraisal methods and techniques with respect to the asset. As an example, in 1986, in connection with our FHLB examination, United spent about \$1 million for new appraisals. In addition, the scope and documentation required in connection with an appraisal is extensive, going far beyond what is otherwise conventional practice in the appraisal industry.

The reappraisal process is thus extremely cumbersome and time consuming. This is frustrating in and of itself, but becomes even more so when the reappraisal occurs in the context of a depressed market in which the collateral property cannot and will not be sold. No purpose seems to be served by obtaining the reappraisal, other than to confirm that a problem loan is a problem or, in some cases, that a performing loan would be a problem if it became delinquent. With deference, I do not believe either an institution or its regulators need frequent reappraisals to reach those conclusions. While the reappraisal theoretically provides an estimate of the size of the problem, I believe this does not actually occur. Rarely is collateral sold

at all in the current market, and even more rarely at the appraisal value — the price may be higher or lower. When property finally is sold or the loan refinanced, it may be sufficiently long after the original reappraisal that yet another reappraisal will be required. Thus, I seriously doubt that reappraisals of collateral provide any reasonable measure of the actual loss that will ultimately be incurred in connection with a problem loan.

This brings me to the second fundamental flaw in the current appraisal process. Aside from the expense and burden of conducting numerous reappraisals, the effect of reappraisal can be onerous. If the revaluation determines that an asset is overvalued, the Bank Board requires the institution to adjust the book value of the asset and establish a specific reserve in the amount of the overvaluation, which concomitantly reduces the institution's regulatory capital. The appraisal requirements of #R 41c, as applied by the Bank Board, require appraisers to make projections and to utilize techniques that do not produce useful estimates of loan quality or of an institution's health. practice, the appraisal process generates the lowest possible estimate of fair market value, rather than the most reasonable estimate. The Board requires that all recognized valuation methods must be presented in an appraisal, but it rejects as inadequate appraisals which do not include all such methods or which do not conclude that the fair market value is in fact at or

close to the lowest of the values produced by different methods. In this way, the Bank Board produces the most conservative (that is, pessimistic) view of loan quality. It also has the effect that the largest possible losses will be estimated, the largest reserves will be required, and the largest number of insolvencies or "supervisory cases" will result. This is not to say the regulators intend this result; it is only to say that it is unrealistic to apply the most conservative appraisal method in a depressed market, and to regard it as determinative of the long term viability of a loan, a portfolio of loans, a lending institution, or a segment of the lending industry.

Let me given you an example, We recently had an appraisal on an apartment project which was built in the early 1980s. At that time, the appraiser projected a 10% per annum rent increase. On the most recent appraisal, however, the same appraiser, utilizing the rules and regulations set forth under #R 41c, projected no rent increases for the next three years and only a 5% increase in the fourth year. Our auditors reviewing the appraisal felt that the 5% increase in the fourth year was unduly optimistic.

Additionally, to determine the value of the property, the appraiser wanted to use a 14-1/2% return as a current return on equities in real estate. Frankly, having spent over 30 years in the real estate business, I can ssure you there are no deals being offered in the United States today that give a 14-1/2%

return on equity. Seven, eight or nine percent returns are much more realistic. Similarly, the appraiser used an 11-1/2% "cost of funds" at a time when one can borrow money all day long at 9-1/2% and 10%. Therefore, the underlying assumptions used by the appraiser, which are not reflective of a readily discernable market, drive the collateral valuation down at a time when thrifts like United are trying to keep a valuation as reasonable as possible.

Thrifts should not be forced immediately to recognize in full losses in the value of real estate collateralizing their loans. In most cases, this real estate collateral would, in a normal market, have a strong underlying value. It is simply unrealistic to require an institution to rebook such collateral at a mere fraction of its value when it cannot and will not be disposed of in a forced fire sale at the bottom of the market. Not only would sales in the current temporarily depressed environment result in little recovery on otherwise valuable collateral, but such sales would compound the problem by glutting the market, forcing down the value of other collateral securing other loans.

For example, United has on many occasions funded the initial construction of homes, townhouses and condominiums and also agreed to loan the money to individual purchasers when these people agreed to acquire a home. In one case that I know of,

United as made loans on over 50 houses in a subdivision at an average price of approximately \$100,000. The loans were made at 90% of appraised value at the time of the loan, or approximately \$90,000. Today, using the information generated by the supervisory people at the Federal Home Loan Bank of Dallas, there has been an approximate 38% decline in Houston real estate values. If we assume these homes had the average decline, the \$100,000 house is now worth approximately \$65,000 - \$70,000. When United is forced to foreclose on a house in the subdivision, using the #R 41c Appraisal technique we obtain an appraisal of approximately \$70,000. If we wish to resell this home, we cannot finance an amount in excess of \$70,000 since neither we nor any other thrift can finance more than 100% of the sale price. Similarly, when an individual wishes to sell his house in the same subdivision, even if he has received an offer of \$80,000 -\$90,000, the buyer cannot obtain financing for more than \$70,000 from a thrift. Appraisers will look at the most recent sales in the subdivision (United's at \$70,000) and determine that the value of the homes in that subdivision is \$70,000. Therefore the maximum loan a purchaser could get would be \$70,000. Thus, single-handedly, we have lowered the value of all homes in that subdivision because of the forced "recognition" of an appraised price reflecting a depressed economy.

As people in that subdivision see their homes losing value, they make the judgment that they are better off "walking away" from their house and returning it to the lender. As the lenders continue to build up their inventory of houses in the subdivision, even the \$70,000 price cannot hold. Sooner or later, one lender (or the receiver of a lender) cracks and sells a home below \$70,000. Then, a new vicious cycle is established, as \$70,000 becomes the ceiling instead of the floor and you again have this forced liquidation.

The fact is that this type of absurd result is becoming commonplace in Houston because of regulatory requirements that loans be classified based on declining collateral real estate values. Mandated loss recognition in such circumstances threatens or eliminates the solvency of many institutions, generating federal receiverships or other approaches. The effect of having more real estate collateral on the market is to cause further declines in the "market value" of the real estate collateralizing loans held by otherwise healthy institutions. Thus, the unrealistic assumptions underlying regulatory revaluation policies become self-fulfilling prophecies, to the ultimate detriment not only of all lending institutions in the area, but of the FSLIC itself and all institutions that fund its operations.

Having said this, I was gratified to see that the FHLBB acknowledged last Thursday that its appraisal policies were having the effects I have just described. Although I have not had sufficient time to review the Board's new policy in detail, it appears to me that the Board still has not addressed with sufficient specificity the single most critical problem for United and many other Texas S&Ls--reliance upon current market value appraisals to determine the value of a loan collateralized by real estate located in an economically depressed area. Unless the Board's new policy includes additional specific provisions to recognize reasonable prospects for future recovery in determining loan value, I believe that the new policy will provide little actual forbearance to thrifts in economically depressed regions.

I know it is going beyond usual legislative practice, but I would hope that somehow the Congress could make clear to the Bank Board the desirability of reducing the frequency with which appraisals are currently required, at least in economically depressed areas. I suggest that the necessity for an appraisal is limited to cases in which a new loan is originated (excluding mere restructurings) or there is an actual disposition of the collateral property. In addition, the Board should be required to accept an appraisal based on any method approved under recognized appraisal standards, deemed appropriate by the appraiser, and consistent with generally accepted accounting principles.

ACCOUNTING

Compounding the problems which any lending institution would face in our market are the specific problems for thrifts which result from the regulatory accounting treatment to which they are subject as compared with that applicable to commercial banks. One of the major areas of difference is the unavailability in practice to thrifts of the Financial Accounting Standards Board Standard 15, commonly referred to as FASB 15. This standard, relating to accounting for troubled loans, allows a creditor to account prospectively for the effects of a debt which has been restructured. FASB 15 essentially allows the creditor to continue to account for the investment in the same manner utilized for the original debt prior to the restructuring, so long as such accounting methods are consistent with generally accepted accounting principles ("GAAP"). The purpose of FASB 15 is to allow an institution to be flexible toward certain troubled debts to avoid a foreclosure proceeding and unnecessary loss recognition which benefits neither party. At the same time, FASB 15 contains numerous provisions to ensure that actual losses are recognized at the proper time and to prevent fraud.

In contrast, Bank Board procedures generally require a reappraisal of underlying collateral at the time a loan is restructured or upon the order of the examiner. For the reasons discussed above, a reappraisal almost universally results in

lower values for collateral and requires that reserves be established and capital be reduced immediately. Thus, although the phased recognition of the effects of debt restructuring is theoretically available to thrifts under FASB 15, in practice it is not. The current "loss" which FASB 15 permits to be deferred over the life of a restructured loan will already have been recognized as a result of the reappraisal before the loan is restructured.

The solution is for the FHLBB to allow thrifts restructuring their troubled loans to forego an appraisal and to account for such restructuring under FASB 15. If thrifts were to use FASB 15, there would be a significant reduction of the pressure on capital ratios for thrifts holding troubled loans which have been, or could be, restructured. This would eliminate the unjustified difference in loan workout treatment available to thrifts as opposed to banks.

The Bank Board's new forbearance policy, which encourages thrifts to "develop work-out strategies with their troubled borrowers where appropriate" and "reaffirm[s] that [GAAP] can be used to permit loan restructuring without loss recognition where appropriate" appears to discuss this issue. As noted, thrift institutions are not able to share the advantages of this type of loan workout accounting unless loss recognition through reappraisals is not required. The Bank Board's statement

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released on Thursday does not contain sufficient details to assure that the advantages of FASB 15 presently applicable to commercial banks regulated by FDIC and the comptroller of the currency, will in fact now be available to thrifts.

Thrifts also receive less favorable treatment than commercial banks in the timing of loss recognition and the effect of establishment of reserves for loan losses. Currently, when a loss is indicated as a result of a reappraisal, a thrift must establish a reserve against the value of the loan. establishment of this reserve results in a corresponding reduction in the institution's capital, and the reserve itself cannot be counted toward the institution's capital requirement. Thus, a loss is recognized on a thrift's balance sheet as soon as the quality of the loan giving rise to it is called into question. Banks, on the other hand, not only are under no obligation to obtain an appraisal which will bring the value of the loan into question, but also are permitted to count loan loss reserves toward regulatory capital requirements. Effectively, establishment of the reserve has a neutral effect on the bank's ability to satisfy regulatory requirements. Once again, the result is disparate treatment of different lenders facing similar problems.

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I note that in its release of last Thursday, the FHLBB states that it will revise its asset classification and loss reserve mechanism so that reserves required with respect to assets classified "Doubtful" will be permitted to be used to satisfy regulatory capital requirements of the FSLIC. Assuming this action will be similarly applied to substandard assets and that no increase in capital requirements will be imposed in connection with such assets, I believe the Board's action is an appropriate first step in removing the regulatory accounting disparities which currently subject thrifts to second-class treatment compared to banks. As I have mentioned, however, further action is needed.

I urge that there be included in connection with any FSLIC recapitalization bill reported out of this Committee a specific directive to the regulators through statutory or report language to eliminate any regulatory practices which have the effect of rendering the benefits of FASB 15 unavailable to thrifts, and to treat the establishment of loan loss reserves by thrifts in economically depressed areas on a basis at least as favorable as that routinely accorded the establishment of similar reserves by commercial banks.

OTHER PROVISIONS OF H.R. 1063

The Bartlett bill, H.R. 1063, contains provisions which would result in improvements in the supervisory process and independent agency status for FSLIC. United has been frustrated, as have other thrifts, with the almost mechanical approach taken by Bank Board examiners to loan classifications and appraisals. We therefore fully endorse the elements of Section 3 of H.R. 1063 which establish an appeal process for Bank Board determinations of appraisal values, loan classifications or reserve requirements. We also support the proposals for review of regulations and procedures to increase the flexibility available to both managers and regulators of the thrift industry.

The bill also provides independent agency status for FSLIC, similar to that enjoyed by the FDIC. Although I assume this is mostly a technical budgetary matter between Congress and the Administration, I also assume that such reclassification would result in greater flexibility for the FSLIC in its internal operations at no additional cost to the regulated entities. We therefore support it.

CONCLUSION

Finally, although I have criticized some of the policies of the Bank Board, my criticism is aimed not at the merits of those policies in the abstract, but at the fact that those polices as currently implemented do not reflect a balancing of broader public policy factors with the strict thrift management policy. The Bank Board's job is to regulate and insure thrifts and its policies are formulated on that basis. However, I believe that an economic depression of the scale which is occurring in the Southwest and elsewhere in the country warrants the consideration of the public impact of regulatory policies outside the scope of thrift regulation per se. These questions are not within the purview of the Bank Board, but are rather the province of Congress, who can weigh the disparate competing interests and fashion an appropriate resolution. Thus, legislation will be required to adequately address the topic.

Thank you for your consideration. I would be happy to respond to any questions you might have.

STATEMENT

PREPARED FOR: SUBCOMMITEE ON FINANCIAL INSTITUTIONS, SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

PRESENTED: MARCH 4, 1987

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Mr. Chairman. Ladies and Gentlemen of the Subcommittee.

My name is Drew Darby, and I am a practicing attorney with offices in San Angelo and Dallas, Texas. Because one of my offices is located in the heart of the oil patch, and my other office is situated in a combat zone which is commonly known as Dallas, my clients and I have been "in the trenches" trying to survive these extraordinary economic times.

I welcome the opportunity to appear before this august body so that each of you may have yet another perspective as to the financial crisis facing thrift institutions across the country. I am painfully aware that the Federal Savings And Loan Insurance Corporation must be recapitalized, and House Bill 27 provides the mechanics for accomplishing this necessary goal. However,

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coupled with said recapitalization, there must be a frame work established which will permit necessary and reasonable regulatory control to co-exist with sound, well-managed thrift institutions. I am convinced that the "Thrift Forbearance And Supervisory Reform Act" being offered as an addition to H.R. 27 is a major step in the right direction. But even this farsighted piece of legislation has not gone far enough in several areas. Section 22A of the Reform Act allows the Federal Home Loan Board to establish its own review and appeal procedure, including the appointment by the Principal Supervisory Agent of a panel of "Independent Arbiters". Ladies and Gentlemen, I submit to you that this provision is deadly similar to letting Dr. Jekyll appoint Mr. Hyde. In our jurisprudence system, you do not let the accused select his own jury. One of the major complaints which my clients have of the present regulatory system is that they are frustrated by the lack of a single individual or group they can report to, and from which they can expect a reasonable and timely answer to their problems. Secondly, they feel the system is ruled through intimidation, and affords them no real venue for appeal or review of the decisions which have robbed them of all normal due process.

Let me give you an example of what is happening from my own experience. About a year ago, countless teams of Federal Auditors descended across the midwest to ascertain the financial condition of all thrift institutions. Because of the size and

extent of the "perceived" problem, these teams were largely composed of young and inexperienced people, who were for the most part, not from that region to which they were assigned. Right, or wrong, the Texas thrift industry believes that the examiner's "marching orders" were to "ride into town, shoot the bad guys, depress values, and hold the bank up until the towns people allow out of state banking". That is precisely what has happened, although I have no complaints about the expulsion of any outlaws from the thrift industry. However, monstrous decisions were made which resulted in the immediate reclassification of loans, which in turn created many "insolvent" institutions. After being notified by the Supervisory Agent of it's precarious financial position, one such client requested that I attend a hastily called meeting between the Supervisory Agent and the institution's Board of Directors. This Board was comprised of local business leaders who owned no part of the institution. Washington attorney was additionally retained to help formulate and propose a reasonable workout plan for the institution. After many hours of thoughtful considerations, the group marched down to the Dallas Federal Home Loan Bank Board, whereupon we assembled in the Supervisory Agent's office. After various opening remarks, the institution's Washington attorney began to outline our proposed recapitalization plan, while at the same time the Supervisory Agent examined the designs on his tie. Shortly thereafter, our Washington attorney was interrupted by the Supervisory Agent with the comment that he didn't care what the institution's plans were, because (as he slammed his glasses down) "this is what you're going to do", whereupon he preceded to dictate, without interruption his plans for the institution. We left the meeting with the feeling, if you will pardon the expression, that we had been "rode hard and put up wet". That group of well meaning businessmen were scared and frustrated, because they knew that the Judge, Jury and Supreme Court had just rendered a final and non-appealable verdict. There was no "due process" or guidance in that hearing, only the booming voice of a regulatory official that had no reviewing authority.

Indeed, a Dallas U. S. District Judge last Thursday ruled that the courts may only judge whether or not the bank board employed "arbitrary and capricious" standards in closing a thrift. Absent Statutory contraints, the regulators answer to no one, including the courts, in determining the life or death of these institutions. The impact is that you better go along with the regulators, regardless of the consequences.

Even though the meeting between the institution and the Supervisory Agent took place nearly nine months ago, the institution has not to this date, received their final audit report. The institution's Board of Directors is operating in a vacuum, not knowing which direction the regulatory winds may blow. They are afraid to stay on the Board for the fear of being sued if the institution is closed. They are afraid to resign because of

the fear that the Supervisory Agent will replace them with a less interested board, whose decisions will exaserbate the situation, thereby creating more losses, which also might result in a lawsuit against the former Board. Even though a State Banking Commissioner Representative is present at all meetings, no final decisions can be made on sale of institution property, workouts on existing loans, without Federal Home Loan Bank Board Approval. For example, this particular institution has property it is trying to sell, and has in fact received an offer for a cash sale which was at least three times the institution's cost The Board of Directors, and the State in the project. Supervisory Representative wanted to sell the property, but were afraid to do so without Federal Approval, because of the fear of not selling the property for enough money. The request for sale remained unanswered for months, while the institution lost a golden opportunity to improve its financial condition.

One of the questions that I have, is where there is evidence of sound management in the institution, why transfer the crucial decision making process from the group who is intimately familiar with a project, to a typically inexperienced, overworked, and largely disinterested individual? This type of supervision simply does not work. A capital forbearance policy must be established which permits institutions which have a weakened capital position, as a result of a general economic decline, to control the decision making process in those matters which

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substantially affect them, their community, and their property rights.

In addition, the review board which is to be established under Section 22A of the Reform Act is a necessary and vital ingredient for any hope of due process in this system. When considering this particular provision, please keep in mind the following:

- The COMPOSITION of the panel (e.g. non-related thrift industry personnel, supervisory agents, and perhaps congressional representatives from the House Select Committee for that district); and
- The INDEPENDENCE of the panel (e.g. appointed by Congress to each Federal Home Loan Bank district); and
- 3. The FINALITY of their decision (e.g. Federal Home Loan Bank President is <u>urged</u>, <u>except in extreme circumstances</u>, to take the recommendation of the panel).

Ladies and Gentlemen, while most of what you have heard during the last several days has been fairly dismal, I am also here to report to you that the situation has improved since the time FSLIC has come to you with outstretched arms for a transfusion of money. I recently had one thrift officer report to me that six months ago ninety percent of all requested workouts from the PHLBB were denied; whereas today, ninety percent of all requested workouts are approved. As long as the Congress of the United States controls the purse strings, and those strings

demand fair play, due process, and accountability, then there is hope for the recovery of the thrift industry.

My statement has been written from the perspective of a lawyer on behalf of his victimized client. Because of recent events, my perspective has changed to that of the victim. After receiving an invitation to appear before you, I was notified that a team of FHLBB investigators had been sent to one of my lenders to examine my personal and business relationship with them. Is this only coincidence? Are these actions an example of proper regulatory control? Is this Orwell's "Big Brother Mentality"?

I am not afraid for myself, because I have done nothing wrong. However, I am fearful of a system that is so sensitive to constructive criticism that it attacks the very credibility of all who would speak out for reform.

Chairman St. Germain is correct when he states that we must insure and preserve regulatory independence. But at what price? Do we sacrifice the right of free speech? Or the right of due process?

The primary issue for you to focus on today is the supervisory process itself, and how it deals with these institutions.

You <u>must</u> make it more sensitive and responsive to the needs of the industry. It <u>must</u> be held to some level of accountability for its actions by the Congress, or the courts!

Thank you for this opportunity.

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<u>STATEMENT</u>

PREPARED FOR: SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,

SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Attata

MARCH 4, 1987

PREPARED BY: THOMAS J. SULLIVAN, JR.

PRESENTED:

TRISTAR CAPITAL CORPORATION

OFFICE: 15770 DALLAS PARKWAY, SUITE 900

DALLAS, TEXAS 75248

Mr. Chairman. Ladies and Gentlemen of the Subcommittee. My name is Thomas Sullivan, I presently reside in Dallas, Texas, and I am President of a real estate development and mortgage brokerage firm.

My financial background covers a wide area of real estate, oil and gas and lending relationships. I have in the past two years been involved in the acquisition and sale of over one hundred million dollars of real estate within the State of Texas, predominately in the Dallas-Fort Worth metroplex area. I have also worked closely with various savings and loans and commercial banks in a mortgage brokerage capacity and in marketing lender owned repossessed properties.

The adverse economic conditions caused by the collapse of the oil industry have been headlined throughout the country. However, the upheavals felt in the energy producing states may

only be the beginning of a much more serious problem, that is the impending collapse of the real estate and thrift industries in those states where the lending institutions are under the heavy regulatory hand of the FHLBB.

I have traveled to Washington, not for a chance to complain, but to offer what I perceive are some constructive comments to aide in the restructuring of the FSLIC fund and to provide additional insight to Congress into the problems we now face in the real estate and thrift industries.

I have condensed the many hours of discussions I have had with lenders and clients into four leading observations and suggestions for your consideration.

I. Thrift Control to Allow For Real Estate Professionals

As in any business, the best person for the job is the person with experience and knowledge in the areas defined by the job description.

A lawyer may not make a good doctor, a doctor may not make a good plumber, and a plumber may not make a good savings and loan owner.

It is ludicrous to assume that a lawyer should not be permitted to be a Congressman because his knowledge and ability to maneuver inside the legal system would make it dangerous for him or her to perform in a law making and regulatory body.

It is equally ludicrous to assume that a competent

and knowledgeable person that makes his livelihood primarily from real estate related activities, even as a developer, would not make an excellent person to own and operate a thrift. In the past, as well as in the present, this classification of a control owner has been denied approval by the FHLBB. The denial is linked to the scenario of "the fox in the hen house", in order to prevent self dealing and conflicts of interest. This denial implies that all people with their primary source of income derived from real estate would become entangled in illegal self dealing.

The competent real estate developer is experienced in fields of asset evaluation, marketing, construction management and financing, which experience is indispensible as it relates to the management of a thrift.

II. Forbearance In Foreclosures Of Real Estate Loans With Achievable Equities

As demonstrated in the past, some of the largest losses in loan collateral values have occurred after foreclosure.

Many properties that are without hope of recovery, or are in the hands of incompetent or unscrupulous owners, should be foreclosed and managed by the receiving institutions or in many cases by (Federal Assistance Disposition Association) FADA.

The bulk of the foreclosures, or those that are candidates for foreclosure, are in that condition because the debtor has become unable to service the loan as agreed in the original loan documents. Presently, it is very difficult to even negotiate the renewal of a loan that is in a "past due" status. Because of these difficulties, posted foreclosures are amounting to over a billion dollars a month in Dallas and Tarrant Counties. After foreclosure, the properties are being returned to the market at wholesale prices which action is pushing down the values of real estate.

In the case of real estate with achievable equities as demonstrated by either current appraisals, or past market trends that should reoccur with absorption and the availability of mortgage money, the existing property owners are typically the most qualified and interested people to manage and market what they have their financial reputation invested in.

I recommend that the lenders forbearance be allowed to provide for the accruing of interest on a mortgage during a specified period, if the debtor demonstrates the willingness and capability to properly manage and market the asset.

The ultimate cost to the savings and loans and the FSLIC fund will prove far less than adding the personnel

and related overhead to manage and market these properties.

III. Asset Acquisition Corporation

The formation of an Asset Acquisition Corporation as a subsidiary of FADA to be funded either by private sources or from the Federal Home Loan Bank system, would provide a much needed entity to purchase foreclosed properties. It is proposed that this entity could acquire foreclosed assets from troubled institutions, relieving them of the burden of holding and maintaining the assets. However, this entity could also be used as an outlet for property sales in lieu of granting forbearance to deserving owners. The Asset Acquisition Corporation would stand to profit from the purchase of undervalued, foreclosed properties in lieu of the owner and would be a formidable competitor in the marketplace.

As a shield against this possibility, I believe this entity should not be allowed to purchase properties from thrifts. Only upon the liquidation of a thrift, should the assets be conveyed to FADA for its offering to the public. A minimum bid price should be established by FADA for a public offering, and only upon not achieving this price, should the assets be sold to the Asset Acquisition Corporation at the minimum bid

value. The Asset Acquisition Corporation will provide for the purchase and ultimate resale of assets with any profits to be distributed to the corporation's investors, with perhaps a percentage to apply to the cost of the requested FSLIC funding.

IV. Creation Of A Healthy Real Estate Industry

A Treasury quotation taken from the U.S. League's Response to Treasury Department Criticisms Of The Savings Institution Self-Help Program For Funding The FSLIC is, "The only reason FSLIC has any reserves is because it has put hundreds of insolvent savings and loans with over a hundred billion dollars of assets on ice. This statement by the Treasury demonstrates that "available financing" has, except for single family residences, been almost eradicated in troubled areas such as Texas, and this restriction of credit is precisely the reason why there is an impending financial collapse of the real estate and thrift industries in those areas where the institutions have been "put on ice".

The ingredients of a healthy real estate industry are:

- A. Product
- B. Buyers
- C. Financing

Without Product and with Buyers and Financing the value for

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Product will increase.

 $\underline{\text{Without}}$ Buyers and $\underline{\text{with}}$ Product and Financing the value for Product will decrease.

<u>Without</u> Financing and <u>with</u> Product and Buyers the value for Product <u>will decrease</u> and <u>continue to decrease</u> as more Product becomes available due to foreclosures.

This elementary economics lesson is being taught to my children in school, but the real estate and thrift industries, along with the regulatory authorities, are learning it through experience.

By virtue of putting "on ice" hundreds of savings and loans which control a hundred billion dollars of assets, the financing available to investors to acquire real estate has been removed, which has further accelerated the demise of the thrift industry and the FSLIC insurance fund. Until the money supply is returned to the market place, the value of real estate will continue to tumble to the point where prices are much lower than the utility value of the product, such as one purchasing a retail corner for the economics of planting a garden.

To restrict or over regulate certain classifications of loans is to remove that financing from the market.

To restrict raw land loans is to remove the first step in the resultant development of any type of end use, including single family residences.

Areas of Texas that have been experiencing a long term steady

growth in real estate values are now subject to wild haphazard value fluctuations due to the dumping by owners and lenders who are unable to carry the burden on the supply side of real estate, without the existence of the supply side of available financing.

I, and the majority of my colleagues in the real estate and thrift industry, desire to see the FSLIC fund recapitalized over a two year period, and subject to the forbearances and restrictions set out in The Thrift Forbearance and Supervisory Reform Act, but with an expanded appeals process to be allowed within this Act.

However, I suggest that recapitalization of FSLIC and forbearance by the regulators will not alone solve the impending collapse in the real estate and thrift industries, unless it is coupled with the renewal of available mortgage money for the acquisition of all types of real estate to be controlled by the suppply and demand forces of the marketplace.

Ladies and Gentlemen, I close with the statement that I did not travel to Washington to testify as a wealthy individual, for I am not, or as the President of a finacially strong real estate investment corporation, which it is not.

I have personally experienced the financial disasters attributed to the collapse of the energy industry as this collapse relates to my own oil exploration and servicing companies. I have experienced the auction sale of my \$3,000,000 drilling rig, in perfect condition, which sold for less than if it had been weighed on the junk yard scales and sold for scrap iron. Also, I have "written off" millions of dollars of accounts receivable from similar companies, and "shut in" dozens of wells that are not economical at today's oil prices.

I am presently fighting for the financial survival of my real estate company and in doing so have experienced most of the problems associated with the real estate industry and the inability to maintain the ownership of properties, even with large current appraised equities, in a market with very little available credit.

I am witnessing the label of "crook" being placed on good people that made credit decisions in the origination or funding of loans, that by hindsight, and fueled by a regulation strangulation of the real estate industry, are proving to be less than prudent decisions by today's standards.

In the Dallas area alone, 5,282 business firms and individuals sought bankruptcy protection in 1986 and even though this number has increased over 55% from the 1985 bankruptcies, the accounting firm of Price Waterhouse predicts that Dallas' failures will continue to rise and not peak until perhaps 1988; and it is the real estate sector that the firm believes will continue to experience a rising number of failures.

I sincerely believe that in testifying here today, and in objecting to the extremely tight monetary controls of the FHLBB that are exacerbating the real estate and thrift industries in my

area, that I am risking retaliation by the very entity that must approve the forbearances my company may need from lenders.

However, I also believe that it is imperative, no matter the cost, that this committee, in public hearings, be informed of the problems facing the real estate and thrift industries from the perspective of the very people experiencing these problems.

Respectively submitted,

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SCOTT W. HUDSON Attorney And Counselor 3636 N. Hall, Suite 906 Dallas, Texas 75219 214/521-8555

February 27, 1987

Fernand J. St. Germain, Chairman U.S. House of Representatives Subcommittee on Financial Institutions Supervision, Regulation and Insurance of Committee on Banking, Finance and Urban Affairs
Ninety-Ninth Congress
Washington, DC 20515

Dear Mr. Chairman:

I am in receipt of your letter of February 24, 1987, together with its enclosures. My background has given me insight into some of the problems that are being addressed by your committee today. Since 1957, I have owned interests in the following financial institutions:

Union Bank and Trust Company in
Fort Worth, Texas
Merchants and Planter's National
Bank in Sherman, Texas
Orange Savings and Loan in Orange,
Texas
Mesquite State Bank in Mesquite, Texas
Home Savings of Dallas County,
Garland, Texas
Sedalia Bank and Trust Company in
Sedalia, Missouri
Colonial Savings and Loan in Lewisville,
Texas

From 1957 to 1969, I owned various interests; but in most instances, I owned a controlling interest in such institutions.

By 1969 I had sold my interests in all institutions. I am a practicing attorney and have direct knowledge and experience representing both borrowers and lenders. I was for three years a prosecuting attorney on the staff of the Dallas County District Attorney. In my business affairs, I have also been a borrower in the past.

I, therefore, have experience as an owner of banks, as an owner of savings and loans, as a director, as an executive of several banks and several savings and loans, as a legal representative of both borrowers and lenders, as an investor and as a borrower. In such capacity I have gained knowledge and insight. I am concerned about the matters before this committee today.

Over a period of the last ten years the Savings and Loan industry has gone through many agonizing and perplexing problems. One very significant change has been the deregulation of savings and loans. Our country and particularly my state, Texas, has been faced with a myriad of economic problems and dislocations. One significant problem was dealing with a cartel ("OPEC") over which we had very little, if any, control. It was this cartel that created unprecedented inflation and, therefore, economic chaos in almost every walk of an ordinary citizens' life.

In dealing with the economic dislocations, our government created a policy that envisioned energy independence. That policy created demands upon the financial systems that were unprecedented and in that regard made the task of the Federal Home Loan Bank system most difficult in coping with the demands placed upon it.

In my opinion the Federal Home Loan Bank System and the Federal Savings and Loan Insurance Corporation as well as the Federal Reserve Bank and Federal Deposit Insurance Corporation became extremely frustrated; began to point their fingers at management of the various Savings and Loan institutions and banks, and created an adversarial relationship. The Federal Home Loan Bank Board should have closed ranks with the institutions to solve the many problems which were created, a significant portion of which were economy driven as opposed to management driven.

The purpose of the Federal Reserve System and the Federal Home Loan Bank Board system is, simply put, to (i) expand credit in a contracting marketplace and (ii) constrict credit in an expanding marketplace while at all times ensuring that public confidence exist in financial institutions. As well as, to ensure that sound and prudent lending policies are being followed. For the reasons mentioned above (predominantly oil and gas problems and deregulation of savings and loans), the State of Texas is currently in a contracting marketplace.

The policies of the Federal Home Loan Bank Board have been counterproductive in the recent past since they have restricted the availability of credit. To partially support this contention, it is my belief that all of the following policies have been counterproductive:

- l. -- The position that all financial institutions should immediately book a reserve to reflect the then current fair market value of real estate held as collateral. This is in direct contravention to "Generally Accepted Accounting Principles" ("GAAP").
- 2. -- The unwillingness by regulators to consider the financial capacity of borrowers to repay loans. People repay loans. Property does not. When was the last time you received a check from a house?
- 3. -- The unwillingness by regulators to allow management to support its position. No check and balance!
- 4. -- The position regardless of market conditions that certain properties must be foreclosed exacerbates an already critical market situation.
- 5. -- The formulation of secret lists which prohibit without cause certain named individuals from obtaining credit. Black lists are being used without any notice to the individual. Discrimination. No check and balance.
- 6. -- The inability to renew loans on a basis that gives borrowers necessary time to repay loans. No consideration of economic circumstances.
- 7. -- The threat by regulators that employees will lose their jobs. Extortion without recourse. No check and balance.
- 8. -- Diversification of investments should be encouraged, not prohibited by red lining. No check and balance.
- 9. -- The threat that institutions will be put into receivership ought to be the last resort. Extreme remedy without due process. No check and balance.

Without being accusatory of individuals who were and/are involved in the regulatory process, I would point out to you that our government has operated best, when it

operated with checks and balances as the framers of our Constitution intended. The framers of our Constitution understood the axiom that "absolute power corrupts absolutely", however the Federal Home Loan Bank System and Federal Savings and Loan Insurance Corporation places absolute power in the hands of a few.

It is fine to say that after an association or financial institution has been taken over by a regulatory agency, we will give them recourse in the courts, but the plain fact is that the game is over and the local community is out in the cold. My recommendation to your committee in dealing with the problems that now exist, where frequent charges of "arbitrary and capricious" action by examiners and supervisory personnel have been made, and continue to be made, is to provide for a check and balance in the form of an "independent" General Counsel appointed and employed by your committee in each of the Federal Home Loan Bank districts. Such an independent General Counsel should be given the appropriate staff and responsibility to represent the various Federal Home Loan Bank districts, but report directly and only to the Congress. It should be obvious that a General Counsel employed by the Federal Home Loan Bank Board and not Congress is nothing more or less than a "hired gun" who takes his orders from the Board, its officers and supervisory agents and owes his job to his employers. Therefore, it would be improbable, if not impossible, for the General Counsel in each district, as it is presently constituted, to ask the appropriate questions, receive input from the local communities, and advise with the local Congressional Representatives as to what might be in the best interest of the local community.

Obviously no one would countenance a crook in charge of a financial institution, and where there is a strong evidence of wrongdoing or for that matter any evidence of wrongdoing is brought to the General Counsel's attention, it is clear in my mind that an immediate investigation should take place. In proceeding with such an investigation, it is only logical that the resources of the local communities should be available to the General Counsel, i.e. local District Attorneys, local United States Attorneys, local police agencies as well as the federal agencies and if the allegations of misconduct are credible, then obviously corrective action could and should be taken, all of which should be in the light of day. The other side of the coin is that if those allegations are incorrect and ill conceived, then appropriate actions should be taken with regard to the regulatory agency. The latter is improbable under the present situation because of paycheck loyalty.

I have read HR27 and HR1063 as well as the various financing plans put forward by the United States Savings and Loan League, the Treasury Department and others. There are

good points in each of the plans; all present methods to get the necessary capital which is so desperately needed. The question that is burning in my mind is what happens after you give them the money? Will the abuses of the past continue in the future? Where is the check and balance with regard to regulatory misconduct, i.e. arbitrary and capricious behavior by the personnel of the various regulatory agencies?

Perhaps I ought to address the question of forebearance (time and patience) which is the subject of legislation proposed by four eminent members of your committee. I agree with the thrust of their bill and many of the technical matters contained therein; however, it does not address the question of how to control a regulatory agency which seems to have run amok.

Considering the need, I cannot imagine a situation where a regulatory agency would object to a representative of Congress (a General Counsel appointed by the committee in each district) unless they felt that they had something to hide or that due process and checks and balances should only be applicable to others.

Obviously, I will be happy to answer any questions propounded by the committee if it is within my power to do so.

Kindest personal regards,

Yours very truly,

Scott W. Hudson

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STATEMENT OF J. O. FOGLEMAN
CHAIRMAN OF THE BOARD OF LOUISIANA SAVINGS ASSOCIATION
LAKE CHARLES, LOUISIANA
TO

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS

Mr. Chairman and Members of the Committee, my name is Jim Fogleman and I am Chairman of the Board of Louisiana Savings Association. I have worked for the company for 35 years. The association is a 500 million dollar shop chartered in 1909 and has 18 offices in central and south Louisiana. It is stock chartered and I am the principal stockholder. The association has a 4% plus reserve position and made acceptable profits during each of the past three years, and paid dividends to the stockholders.

The economy of Louisiana is a disaster as a result of energy problems, agriculture problems, and declines in shipping from our ports. Evidence points toward further declines. Our unemployment at 14.3% is the worst in any of the 50 states and is almost twice the national average.

There are 102 associations in Louisiana having total assets of 15.6 Billion dollars. 38 of these associations lost money during the first 3 quarters of 1986. The net losses of all 102 associations averaged 9 million dollars a month during that 9 months. When our customers are hurting economically, we are hurting. The prospects for 1987 are much, much worse. Most of these associations are well run by competent managers and directed by responsible Boards of Directors. The economic conditions simply make it impossible to operate profitably. In order formany of these associations to survive and to continue to meet the needs of their customers they must have Regulatory forbearance until economic conditions improve.

Because of my senior citizen status and long years in the business I have received many telephone calls from managers relating horror stories of substantial write downs on assets as a result of R4IC appraisals required by regulations, on properties acquired by foreclosures. These appraisal write downs are a substantial part of the losses previously referred to. As economic conditions improve in Louisiana, and they will, the value of these properties will improve and we may well find that the losses need not have been recorded at all. Unless capital requirements and asset write downs are substantially relaxed in well managed associations many will be problems of the FSLIC long before economic recovery would have made than whole.

In order that the FHLB Board may be fully protected in the administration of its duties I urge your favorable consideration of Representative Bartlett's amendment to H. R. 27. I sincerely believe that the completed version of the amendment after it has completed the legislative process will largely explain the concensus attitude of this congress and will greatly assist the FHLB Board.

The FSLIC will require substantial additional funds to deal with the problem cases it currently has and those it will acquire even with forbearance policies in effect. It is impossible to accurately predict just how much will be needed just as it is impossible to predict when the economy will improve. It is for that reason that I respectfully urge the favorable consideration of the U. S. League two year plan to recaptilize the FSLIC. The details have been carefully considered by the members of the largest and most professional trade organization to represent the business. These are the folks who are now paying the bill and will continue to do so. Just to illustrate our stockholders are currently being assessed fifteen hundred dollars a day to pay for problems we did not create nor have the authority to prevent. We must minimize that assessment.

I respectfully urge this Sub-Committee to approve the two year recap plan of the U. S. League.

The approximately 5 Billion dollars a year for each of two years that we, the business, will be making available to the FHLB Board must be wisely used. During the past decade the ineffectiveness and lack of stability of the leadership of the FHLB Board has been a significant part of the cause of the problems of the industry both in failing to prepare for the interest rate crisis that battered the reserves of the associations and in allowing the undesirable high flyers that have cost us so much.

If adjustable rate mortgages and the greater operating powers that were granted by the Garn-St. Germaine bill had been granted five years earlier, then much of the effect of the interest rate crisis could have been avoided. You, Mr. Chairman, and the other members of the congress granted those powers when the needs were presented to you. Had those needs been effectively presented to the congress at the same time as the cost of savings, in the form of money market certificates, was freed from regulation Q and allowed to follow market interest rates, the results of high rates would have been substantially reduced for the business.

If supervision had been more effective, the devastation caused by the high flyers could have been greatly reduced. In Louisiana for example, in at least one instance which has been widely discussed by others in the business, individuals who had been in control of an association that had become a problem case of the FSLIC were allowed to have another charter and now that second association is also a problem of the FSLIC. Millions of dollars of losses will now have to be absorbed by the rest of us.

The problem is in the structure of the FHLB Board, the present three person board is simply not large enough to deal with what has become an industry of widely different types of associations. The lack of continuity caused by too few members serving for terms that are not long enough on a staggered term basis has kept the board from providing the stable and effective leadership that is assential.

The individuals who have served on the FHLB Board during this past decade have struggled valiantly to provide the needed leadership. I do not know of even one of the numerous individuals who have served who has not given his or her best effort. They have collectively done a truly outstanding job in the face of overwhelming odds. Perhaps the magnitude of the responsibilities has contributed to the short pariod of time several have served.

The frequency of turnover of board members has made it difficult to attract and keep top staff members. At the very time that the FSLIC is having more problems that at any time in its history there is no director. The last person who served as director of the FSLIC was an executive on loan from one of the F. H. L. Banks. He has recently returned to serve as president of one of the F H. L. Banks We therefore now find ourselves in the unique position of asking the congress to provide the vehicle for making available 10 Billion dollars of funds which will come from the industry to an agency which has no director.

I believe the funds must be made available but I believe that the FHLB Board must be re-structured at the same time.

I sincerely believe that a larger board serving longer, staggered terms is essential to direct the industry through these troubled times and to minimize the cost and prevent the reoccurance of the costly dilemma of today. Perhaps it too should be patterned along the lines of the Federal Reserve Board and also have representation on a rotating basis from the presidents of the District Federal Home Loan Banks.

I respectfully urge this committee to add an amendment to H. R. 27 which will create a board of five to seven members serving terms, on a staggered basis, of at leas five years Since funds for recapitalization will in part be provided by our FHLB system, I believe that the considerable talents of the FHLB Presidents should be utilized by adding two of them to the board on a rotating basis This will be a major step toward re-establishing the strength and stability that is needed if our industry is to continue serving the savings and home loan needs of our country.

Thank you for listening.

Statement of

Don D. Guidry

Presented before the
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance

U. S. House of Representatives
Washington, D. C.

March 4, 1987

Honorable Fernand J. St. Germain Chairman Sub Committee on Financial Institutions U. S. House of Representatives Washington, D. C. 20515

Re: FSLIC Recapitalization and related issues

Mr. Chairman and members of the Committee:

My name is Don D. Guidry. I am President of Lafayette Building Association, a Louisiana Savings and Loan, mutually chartered in 1900, with current assets of \$236,000,000 and net worth of 6.8%.

The Savings and Loan Industry has been my livelihood since 1959.

I've seen the dream of home ownership through the eyes of many people.

I have also witnessed this dream turn to nightmares for many.

Sure, today FSLIC and the Savings and Loan Industry has great challenges, however our consumers are the ones with the greatest challenges. I come before you today with a tremendous sense of urgency.

I've been out of work for six months.

We've used all our savings.

We've sold everything we could to make our house payments,

- BUT -

We can't pay anymore.

We can't refinance, our credit has gone bad.

We can't sell our home, the appraisal is \$20,000.00 less than my loan balance.

What are we going to do?

These are several remarks made by consumers today, consumers who were never even 30 days late making payments and now are losing their homes; this could be you, if only you lived in Lafayette, Louisiana.

I'm truly confident, with our government's ability to act, not react to our present situation, and with our regulators being supportive, we will maintain the stability of our thrift industry while preserving public confidence in the safety and soundness of our institutions.

Our challenges today are the direct results of legislative history, changes we made to assure home ownership. Our Congress has always been supportive in providing ways to better serve our communities. Now, times have changed and these provisions for home ownership, while they did work, must be directed to the preservation of the Dream.

Before addressing the issues at hand, let's understand what led us to our challenge:

Regulation Q was set up because of a competetive disadvantage to thrifts in permitting banks to offer a full range of services to the public.

Result today - Loss of identity and purpose of Banks and $\mbox{Thrifts.}$

Our concern for the "Small Savers" led us to the "Sense of the Senate" resolution. This permitted reduced minimums on money market certificates. Institutions were permitted to issue certificates at rates referenced to a rate payable on a class

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of U. S. Obligations.

Result today - Deterioration of institutions reserves while creating hardship to the person seeking long term financing.

Tax-exempt bond issues for mortgage lending. This instrument was designed to provide more dollars for housing and at the same time, an incentive to increase the base of middle income households to move back to the city.

Result today - The cities overlooked the real reason for these households leaving in the first place, while compounding the problem by heading a program that affected the private mortgage market and inflated appraised values above the real market.

Restructing below market loan portfolios, an attempt to improve an institutions ability to earn more income in a period of high interest rates.

Result today -

To our Industry: a long term competitive disadvantage.

To our borrowers: higher mortgage rates.

To our savers: penalties for early withdrawals to capitalize on high short term rates.

To FSLIC: dollars spent to liquidate many thrifts.

To the Treasury: tax dollars.

When you are unhealthy you are subject to further disease. .

Result today - Many dollars have been spent by FSLIC in permitting new charters and acquisitions by people interested in capitalizing on an ailing industry rather than interested in providing a service to our communities. Additional dollars were spent on firms unrelated to our industry in assisting many thrift institutions to restructure their loan portfolios. These firms gained profits for themselves at the expense of the FSLIC.

As can be noted from the above, many actions of the past implemented to assist our industry, the FSLIC, and our public, have caused equal misery. No matter how the issues are disguised, the eventual cost is shared by the public. Today we're faced with H.R. 27, the FSLIC Recapitalization Bill and H.R. 1063, the Thrift Forbearance and Supervisory Act, as an addition to H.R. 27.

My comments are directed with utmost urgency, and in priority form due to deepening economic depressions not only in Louisiana, but in various states. This depression will continue to spread to other states if priorities are not followed.

<u>First</u>, a forebearance policy for well-managed institutions located in depressed economic areas must be adopted by our regulatory and supervisory agencies. This will provide work out plans, without reserve allocations due to economic conditions.

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Second, "Classification of Assets" regulation adopted by the Federal Home Loan Bank Board in 1986 must be removed when property is secured with Real Estate. We must appreciate the fact that depressed areas are temporary in nature.

Third, new appraisals on property acquired through foreclosure, or property held over a year must be discontinued as used to affect current operating profit and loss. These appraisals reflect depressed prices rather than value.

Fourth, remove the regulatory capital requirement (6%) in areas economically depressed as it creates a disadvantage to consumers desiring to bring deposits to the well-managed institutions. Their deposits will have to earn rates less than market or these dollars will deteriorate our base, in loss of savings accounts. Even the well-managed institutions will be encouraged or forced to take undue risk to increase earnings. It's an encouragement of risk taking to our Industry as opposed to soundness.

Assistance to FSLIC is necessary in the form of the U. S. League's Plan. The FSLIC and the Industry must not be burdened with huge debt services, especially at a time when the amount of dollars really needed cannot be determined. The important point is that something must be done now to assist the industry in the economically distressed areas and not to provide FSLIC with a level of funds as if the whole country were economically depressed. Our Congress is working hard to

bring these areas back into production and as this occurs, the market will provide many dollars, that will otherwise become part of the debt, so huge that the eventual solution will be financed by our public.

We must look to a "self help" plan with strong commitments from our Congress, FSLIC, our Industry, and our Regulators. Again, in order of priority:

<u>First</u>, a temporary moritorium, must be placed on the "dumping" of assets in economically depressed areas. This action penalizes well-managed institutions, consumers having equity positions, and the resources of FSLIC. (See Exhibit A)

Second, identify well-managed (1) institutions.

Third, a financing corporation as proposed in H.R. 27.

Fourth, New charters should be denied "Insurance of Accounts" for a period of 5 years, as this would provide time for management to prove themselves to be a service to the community.

 A well-managed institution is defined as one that has a charter which is at least ten years old, and has at least 3% net worth according to generally accepted accounting principles. - 7 -

Fifth, assets of the ailing institutions that would be acquired through recapitalization dollars should be held (not disposed of) and used as collateral for issuance of zero coupon bonds, based on the assets' current appraisals, to be retired in 5, 10, 15, and 20 years as the real estate market appreciates. The end result would be an infusion of capital to the FSLIC at the expense of neither the industry nor the consumer.

Sixth, an incentive, provided to financial institutions through advances at below market rates up to their loan values on REO properties, would permit the institutions to retain the REO rather than selling it, as this would otherwise create a false selling market. The funds acquired through the advances would be re-invested in a designated asset to bring a 2% margin to the institutions. As the market improves and properties are disposed of, the advances would be retired and the associations could sell its designated asset and re-invest elsewhere.

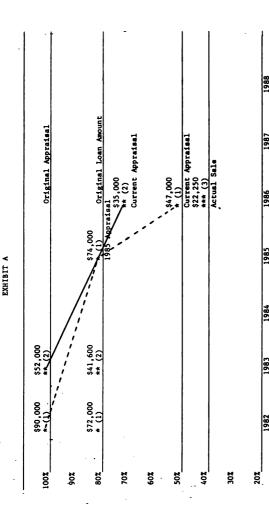
We desperately need action to create incentives for people to save money for housing. People have become more knowledgeable and sophisticated in the matter of investing savings dollars. It is apparent that the concept of providing money for housing is no longer important to those who already have homes. Equally important is to have our industry re-commit to housing, as this has changed somewhat because of the need to generate more income.

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We urge legislation to provide tax free interest on deposits to people who invest into institutions having at least 70% of their assets invested in liquid-assets and residential loans.

Conclusion

I have appreciated the opportunity to testify before this committee and look forward to positive action on the part of this committee, the House, the Senate and the Administration in addressing the issues affecting the industry, FSLIC and most important, the preservation of Our American Dream, Home Ownership.



Properties (1) and (2) were held by our association. Regulatory requirements resulted in, \$25,000 property (1) and \$6,600 property (2), \$31,600 of charges against current operations. This is a true example of economic depression, given time to correct, will be later absorbed by the market, at no loss.

Property (3) a similar property in the same neighborhood sold at PNMA suction 5 months after our last appraisal, will further affect our market by \$4,430, and our institutions operating earnings at 10 1987, as these figures are used as comparables. It is obvious that such appraisals are a reflection of economic depression rather than values.

The practice of "Fire Sale" or dumping of assets penalizes institutions as well as, and more importantly, consumers whose equity position is eroded assy by comparables in the market that are not true values of real estate, but merely reflect prices in a temporarily distressed area of the country.

STATEMENT OF

FARM & HOME SAVINGS ASSOCIATION AND THE

U.S. LEAGUE OF SAVINGS INSTITUTIONS

PRESENTED BY DONALD F. ROBY

BEFORE THE COMMITTEE ON BANKING, FINANCE & URBAN AFFAIRS U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.
MARCH 3, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Donald F. Roby. I am President of Farm & Home Savings Association, Nevada, Missouri, and appear today to present my views on H.R. 27, H.R. 1063 and other matters relative to the thrift industry.

Farm & Home Savings Associations is a \$3.3 billion state chartered publicly held savings and loan association headquartered in Nevada, Missouri. The association was founded in 1893 and has seventy-six offices throughout Missouri and Texas.

I joined Farm & Home late last summer and immediately prior to that I was President of the Federal Home Loan Bank of Des Moines. I was a member of the U.S. League's FSLIC Task Force and served on the Subcommittee on Regional Problems.

All of us in the savings and loan business appreciate the time and effort being expended on the matter of recapitalizing the FSLIC and on the many facets of the problems attendant thereto. My own view (and I am confident the view of a large majority of those in the industry) is that the restoration of fiscal integrity of the FSLIC is paramount. The plan presented in H.R. 27, as well as the plan presented by the U.S. League, focuses on the problem and it is important that something be done. My personal preference is to limit the duration of the authorization and the magnitude of the borrowing as advocated

by the U.S. League because it seems to provide as much cash flow in the first two years and appears to be less costly overall. Then, too, additional Congressional oversight is a built-in part of the program in the event that additional funding is required. Those presenting the plans seem to take extreme views as to adequacy of funding, timeliness and other features. One fact that both plans seem to agree upon -- the industry pays the bills. Any funds taken out of the Bank System reduce the income available for dividends to the member stockholders any way you want to do it. Therefore, it would seem more logical to start with a smaller plan and expand it if and when necessary, but certainly after adequate staffing has been acquired. The feature calling for an industry advisory committee to FSLIC seems like a good step in order to provide increased accountability. Most of us would agree with the old adage that people tend to do what you inspect rather than what you expect.

H.R. 1063 seems to cover all of the points of forbearance recommended by the U.S. League Task Force and more. The subcommittee of which I was a member recommended that the Bank Board adapt a policy of forbearance similar to that adapted by the other federal banking agencies in April, 1986. I would favor legislation which gives firm direction to regulators rather than spelling out the details. For example, accounting

rules and interpretations change over time and regulators (and the industry) need some flexibility to respond. I can't believe that a strong "sense of the Congress" message could or would be overlooked by those affected.

While I certainly agree with most of the items contained within H.R. 1063, I am concerned about the first provision of the proposal which would provide for the amortization of losses by qualified associations on qualified loans. A practical problem arises in the case of a large participation loan — what if, for example, some of the participants are qualified associations and some are not — or — the loan is qualified as to some participants and not as to others. In general, accounting treatment which is different from the standard or from generally accepted accounting principles usually causes continuing problems. Differences require footnotes and explanatory material.

The Federal Home loan Bank Board has very recently released a formal policy on forbearance. It appears to go a long way in responding to the need for forbearance and in bringing about some needed change. It is difficult to comment upon it in that it has so recently been issued and, further, some of the news releases only refer to changes which will be. It does not, it seems at this time, adequately cover the need to evaluate loans in accordance with GAAP and I believe that change needs to be addressed.

Finally, you asked for my comments relative to charges of "arbitrary and capricious" actions by examiners and supervisory personnel. I have heard some of those comments and I am sure they are not all without foundation. Prior to the rather recent transfer of the examiner to the Federal Home Loan Banks, the examination function was hampered by inadequate numbers of staff, and it was extremely difficult to retain experienced personnel. As a result, some of the districts were woefully behind schedule in examining member institutions. During the past twenty months, there has been a significant increase in both the examining and supervisory staff. A massive training effort has been underway since that time in order to provide the most qualified personnel to this important function. To aid in that training, the Office of Education was established by the Federal Home Loan Banks, and it has been steadily increasing its role over the past two years. Increased salary schedules and benefit plans have allowed the banks to attract many highly qualified and skilled individuals to both the examining and supervisory activities. In other words, I believe the improved quality of these staffs will go a long way in responding to these problems.

I would further suggest that there is a strong need for management officials in the thrift industry to take a <u>pro</u>active role with respect to their problems as they develop rather than

a reactive role. That is, they need to quickly recognize their problems and develop at least a proposed plan of workout. The next step I would suggest would be to schedule a meeting with the examination and/or supervisory personnel, including the Principal Supervisory Agent, if necessary, in order to "clear the air" and start the corrective processes. While I certainly cannot speak for all of them (matter of fact, I can't speak for any of them), I don't know of any Principal Supervisory Agent who would not be willing to work with member institutions in programs of rehabilitation.

Thank you very much for the opportunity to appear here today.

STATEMENT OF

NOLAN L. RUMBLEY

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE & URBAN AFFAIRS

WASHINGTON, D.C.
MARCH 4, 1987

My name is Nolan L. Rumbley. I am the Executive Vice

President and Chief Operating Officer of American Federal

Savings and Loan Association of Iowa (American Federal) located
in Des Moines, Iowa 50307-2597, telephone number 515-245-5606.

I appreciate the opportunity to appear today to present my
perspective on the Federal Savings and Loan Insurance

Corporation (FSLIC) recapitalization and the need for effective
forbearance as part of your legislative consideration.

American Federal has \$1,070,000,000 in assets and is Iowa's largest savings and loan. We are a state wide financial institution serving markets from 22 branches in Iowa. Our investment in first mortgage real estate loans (loans) is approximately \$820,000,000 and we have approximately 150,000 customers throughout the state.

As a priority, American Federal has always supported the its local markets when considering investing its available funds; however, at times Iowa has been a capital-excess state and approximately \$400,000,000 of our loan portfolio are loans that we have purchased, primarily out-of-state. Approximately \$103,000,000 of our purchased loans are from the state of Texas with approximately \$72,000,000 from Houston. This investment

position makes us very involved with the state of Texas and its economy. We find ourselves in a position of being domiciled in an economically-depressed state due to agriculture with major investments in another economically-depressed state due to oil. Our position also illustrates that economic problems are not necessarily limited to specific geographic areas.

For an area of any size, city, state or region to become economically depressed, there must be a reduction in the demand for the products and services provided by that area. The ability of an economically-depressed area to return to full capacity to provide those same products and services remains, and the facilities and work force are available for utilization to produce alternative products and services. As has been proven in the past, an economically-depressed area will regain economic strength with the passage of time. For this reason, any FSLIC recapitalization and accompanying forbearance should include the following considerations:

- Economically-depressed areas will regain strength with the passage of time.
- Real estate valuations in economically-depressed areas should include the value that will be regained in the foreseeable future.
- 3. What may appear to be corrective actions by the FSLIC due to economically-depressed areas should not be applied in strength at the heighth of a crisis and at the bottom of market values.

I believe there is a necessity to recapitalize the FSLIC and maintain its independence as a promoter of thrift and home ownership. I also believe that the recapitalization should be done conservatively and in conjunction with some type of forbearance to minimize cash needs and help maintain as much of the savings and loan system as is possible. Future increases in real estate market values will be realized and will strengthen the financial position of savings and loans located in and with investments in economically-depressed areas.

If the FSLIC recapitalization were to provide large amounts of discretionary funds, I would have the following concerns:

- That the FSLIC would not be able to administer the funds properly due to facilities and staffing.
- 2. That overreacting would eliminate many savings and loans that could be viable financial institutions in the future.
- 3. That a major disposition of problem assets would further depress real estate values in economically-depressed areas.

The recapitalization plan proposed by the United States

League of Savings Institutions, along with an effective

forbearance plan, would seem to eliminate the above concerns.

An effective forbearance plan is an essential part of an FSLIC recapitalization plan. A forbearance plan should be for:

- 1. Savings and loans located in those with investments in economically-depressed areas.
- 2. Savings and loans that are well-managed and have shown good business judgment in the past.
- 3. Savings and loans that will be viable financial institutions in the future.

A forbearance plan should include the following:

- Forbearance from net worth requirements, due to loans in economically-depressed areas.
- 2. Avoidance of excessive write-downs by:
- a. Use of generally accepted accounting principles (GAAP) when accounting for problem assets.
- b. Use of a real estate evaluation process that would recognize potential values.
- c. Amortizing losses to avoid overstating while economic recovery occurs.
- Elimination of the double penalty imposed on problem, income-producing properties through classification of assets and scheduled items.

The above would minimize the short-term cash needs, the overall cash needs and excessive carrying costs of the FSLIC.

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In conclusion, I believe there should be a recapitalization of the FSLIC that is conservative and accompanied by effective forbearance for savings and loans holding loans in economically-depressed areas.

Thank you for your attention. I look forward to your questions.

TESTIMONY OF JAMES R. TURNER BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS OF THE COMMITTEE ON BANKING U.S. HOUSE OF REPRESENTATIVES MARCH 4, 1987

Mr. Chairman. Members of the Committee. It is a privilege to appear before the Subcommittee on Financial Institutions to-day. My name is Jim Turner and I am President of the Kansas League of Savings Institutions, a position I've held for the past 16 years.

The Kansas League of Savings Institutions is comprised of 57 federally and state-chartered thrift institutions, both savings and loans and savings banks insured by the Federal Savings and Loan Insurance Corporation (FSLIC). The membership of the League is comprised of stock and mutual institutions having over 200 branches statewide. The combined assets of Kansas thrift institutions is in excess of \$16 billion dollars.

The Kansas economy is depressed. This is evidenced by the increase in unemployment, farm foreclosures, the closure of over 30 commercial banks in the past two years, and the recent decision of the Kansas Legislature to cut State spending across the board by 3.9%. For thrift institutions this economic decline is evidenced by a 58% increase in repossessed assets in the past nine months with REO now representing 1.1% of total assets with the Kansas economy so heavily dependent upon agriculture, oil and gas, and the aircraft industry.....1t is obvious that we have economic problems.

Despite such problems the thrift institutions in Kansas continue to survive. Kansas thrifts enjoyed combined earnings of \$160 million for the first nine months of 1986 when compared to the same period in 1985. However, it is important to note that only \$16 million of this income was generated in the third quarter. The impact of the declining economy in the midwest is slowly spreading to our member institutions.

Of the four states comprising the 10th Federal Home Loan Bank District (Kansas, Nebraska, Oklahoma, Colorado), only Kansas has a positive return on average assets as evidenced by the enclosed financial data prepared by the Federal Home Loan Bank of Topeka (Appendix A) Kansas thrift institutions continue to maintain a strong regulatory net worth position of 5.29%.

The economic conditions in Kansas and the midwest continue to deteriorate as does the financial strength and conditions of our member thrift institutions. The combination of a declining economy, mistakes made in coping with deregulation and the expanded participation in the secondary market has resulted in the spread of questionable, or bad, assets to Kansas. Indeed, these participations are spread throughout the country. The thrift industry has an asset problem which will take money, time, patience, and quality management to resolve.

This is the purpose of our presence before the Subcommittee today. We need recapitalization of the FSLIC fund now. We needed it yesterday. It is time to set divisive factors aside and get on with the essential task of recreating a strong FSLIC.

Yet, while we strongly support immediate enactment of FSLIC recapitalization, we are equally strong in our support for legislatively mandated forbearance for well-managed institutions. The failure to enact both proposals simultaneously would be a mistake, counter-productive, and would result in Congress having to readdress recapitalization again in the near future.

The official position of the Kansas League of Savings Institutions as adopted by our Legislative Committee is as follows:

"Resolved that KLSI support programs allowing forbearance in economically depressed areas as well as a realistic and affordable recapitalization of the FSLIC with consideration given to implementation of the plan proposed by the U.S. League."

We applaud Chairman St Germain and Congressman Wylie for their introduction of H.R. 27. The bill represents an excellent point of departure for the resolution of appropriately funding the FSLIC in the future. We are supportive of the U.S. League's proposal for \$5 billion in funding with the issue to be revisited by Congress in two years for the following reasons:

- A grave concern regarding the ability of the FSLIC to adequately manage an amount in excess of \$5 billion, and
- Concerns about the future debt obligations to our member institutions.

We are pleased that there are reports that a reasonable compromise and a workable funding mechanism may be achieved.

The major reason for our presence before the Subcommittee today is to discuss forbearance.....and the essential need for Congress to mandate such a program to the Federal Home Loan Bank Board. Our support for mandated forbearance is based on:

- A concern that the FHLBB will not realistically and reasonably address a forbearance program absent direction from Congress,
- A recognition that most of our problems are a result of depressed economic conditions in the area which we feel will improve in time,
- A concern that the scarce resources of the FSLIC will be dissipated unless coordinated with a viable forbearance plan, and
- A belief that forbearance will allow FHLBB officials to acquire control of supervisory and examination personnel in the field.

While the issue of forbearance has been discussed within industry circles, chronicled in the media, and placed before Congress during the past six weeks — the Federal Home Loan Bank Board has demonstrated no initiative to implement such a program. It appears that the Bank Board perceives the solution to the problems of the industry as being "more FSLIC money". We do not feel that the industry or Congress can afford a "money only" solution.

A precedent for the provision of forbearance was established last year for "well-managed" commercial banks by the Office of the Comptroller of the Currency (See Federal Register, April 23, 1986, p. 15305). A mandate from Congress to the FHLBB to issue guidelines to the regional Federal Home Banks Principal Supervisory Agents to implement a forbearance program appears workable. While this is a subjective approach it is not beyond the scope of reasonable guidelines which the Bank Board or PSAs can develop. However, it is essential that the legislation preclude the requirement of a "consent agreement" prior to granting of forbearance.

Secondly, while economic conditions are depressed in Kansas and other parts of the country we feel that....in time....the agricultural economy and the oil and gas industry will rebound. Indeed, with the U.S. dependence on OPEC oil again approaching 50% it is not inconceivable that we will once again see automobiles "lined up" to secure gas along with an increase in petroleum prices and a resurgence in domestic production. Also, as land values moderate and greater expertise is developed to tap global markets, we anticipate a future recovery in agriculture.

It is imperative that the Subcommittee recognize that most of the "bad loans" were "good loans" at the time of origination; based on viable appraisals, appropriate supporting credit, and good management review. We are confident that the restoration of the economy in the midwest and Sun Belt states will result in a substantial number of these present day "bad loans" once again becoming "good loans." This can be accomplished only through forbearance and the use of GAAP to account for problem assets.

Third. Absent a forbearance program we fear that the scarce resources of the FSLIC, including the proposed amount of recapitalization, will be dissipated. The recent history of FSLIC has not demonstrated their ability to be good stewards of funds available. Indeed, it is my understanding that Congressman Dingell's committee is presently looking into the stewardship of FSLIC funds.

An appropriate forbearance program will reduce the perceived need of the FSLIC staff to address asset problems merely on a "dollar basis." It is not necessary to recite the dollar magnitude of asset problems. The worst case scenario of the General Accounting Office will suffice. A forbearance program that allows for appropriate workout resolutions of loan problems will substantially reduce the dollar amount of FSLIC obligations.

Finally, we believe that an appropriate forbearance program will allow the regional Bank Presidents (PSAs) to implement programs to better direct the field examiners and supervisory agents. With few exceptions, we believe that the field examina-

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TABLE G
Changes (millions) during 3Q86

			NW/TA	
	NW	Assets	JUN 30	SEP 30
District	\$ +13.9	\$+806.8	4.19%	4.15%
Colorado	-28.7	+103.9	5.11	4.89
Kansas	+61.0	+477.6	5.07	5.29
Nebraska	-15.7	. +146.7	3.16	2.93
Oklahoma	-2.7	+78.2	2.24	2.19

Table H presents a breakdown of foreclosed real estate over the last nine quarters. These rates represent an annualized rate of quarterly foreclosure activity. Each quarterly dollar activity total is multiplied by four and divided by the total mortgage portfolio at the beginning of the quarter. After a foreclosure takes place, the property appears in the category of repossessed assets, a history of which appears in Table J.

TABLE H

Foreclosure Rate
(Annualized percent of beginning mortgage balance)

	US	DIST	CO	KS	NE	OK
SEP86	1.85%	2.07%	1.85%	1.43%	2.26%	3.39%
JUN86	1.64	2.18	1.87	1.69	2.04	3.62
MAR86	1.43	2.15	2.27	0.81	1.89	4.53
DEC85	1.30	1.67	1.98	1.07	1.16	2.66
SEP85	1.23	1.53	1.67	0.71	1.70	2.44
JUN85	1.00	1.37	1.19	1.49	1.09	1.70
MAR85	1.24	1.37	2.03	0.91	0.60	1.76
DEC84	1.16	0.87	0.82	0.53	0.74	1.54
SEP84	0.81	1.12	1.74	0.65	0.61	1.40

Table J presents a breakdown of total repossessed assets over the last nine quarters. This ratio represents the total dollar value of all repossessed assets (real estate owned as a result of foreclosure or deed in lieu plus any other repossessed items such as motor vehicles) at the end of the quarter as a percent of total assets at that time.

Scheduled items as a percent of total assets are shown for the District and states over the last five quarters in Table K. Aggregate data on this item were not available before June 30, 1985, and U.S. data for December 31, 1985 are listed in the aggregate reports as "not available." Scheduled items include all repossessed assets, slow loans, nonconforming loans and contracts,

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and certain other assets such as those classified as substandard under federal regulations.

TABLE J

Repossessed Assets
(Percent of total assets)

	US	DIST	co	KS	NE	OK
SEP86	1.23%	1.82%	1.72%	1.23%	1.66%	3.11%
JUN86	1.13	1.63	1.61	1.15	1.42	2.62
MAR86	1.01	1.44	1.51	0.94	1.13	2.37
DEC85	0.87	1.22	1.41	0.83	0.87	1.86
SEP85	0.80	1.16	1.41	0.79	0.76	1.66
JUN85	0.73	1.00	1.13	0.77	0.57	1.48
MAR85	0.66	0.90	1.18	0.61	0.52	1.18
DEC84	0.55	0.79	1.10	0.48	0.49	1.00
SEP84	0.52	0.76	1.16	0.48	0.47	0.81

TABLE K

Scheduled items (Percent of total assets)

	US	DIST	co	KS	NE	OK
SEP86	3.11%	4.82%	3.70%	3.20%	3.59%	10.33%
JUN86	2.89	4.41	3.57	2.96	3.30	8.98
MAR86	2.76	4.10	3.43	2.59	3.33	8.09
DEC85	N/A	3.54	3.28	2.29	2.68	6.53
SEP85	2.33	3.01	2.78	2.06	2.11	5.45
JUN85	2.10	2.62	2.48	1.98	1.70	4.42

Tables 1 and 2 on the following pages present quarterly changes in selected items. Table 3 shows the District's one-year gap over the last 10 quarters, and tables 4 through 6 present year-over-year changes for selected items.

Mark McLelland January 10, 1987

APPENDIX B

SAVINGS AND LOAN SUPERVISION IN THE 80'S . . .

The Death Of Discretion Or Growing Pains?

As a former senior staff member of the Federal Savings and Loan Insurance Corporation (FSLIC) and a Federal Home Loan Bank Board (Bank Board) office Director, it is time for me to make a confession. The confession provides the basis of my topic, "Savings and Loan Supervision in the 80s-The Death of Discretion or Growing Pains?"

In the past few years we made some big mistakes as regulators. Going back to the Pratt administration, which I was a part of, we made some big mistakes. I'm a great admirer of Dick Pratt and I was honored to be a part of his administration. Like Dick, I'm a believer in free enterprise, market discipline, and deregulation-let's call that less regulation—but what we in the Pratt administration failed to recognize, was that by loosening regulation, there would be a resultant explosive growth in the industry; that the cost of marketplace discipline was far, far more than the FSLIC or the industry could withstand; and we failed to foresee the impact of deregulation upon the regulatory structure itself.

Suddenly, deregulation propelled us regulators into a world of Empire Savings of Mesquite, San Marinos and Sunrise Savings . . . remember Sunrise, remember the Forbes or Fortune article about "life in the warm and fuzzy lane" . . this was the management style of the future, the way to go? Sunrise, of course, has become "Sunburst" and is now estimated to cost FSLIC something like \$650 million. Then there's Bell Savings out in California, \$484 million in 1982, \$2.1 billion in 1984, and now à FSLIC problem. We didn't anticipate this kind of explosive growth.

We had an industry that for years and years and years focused on how to get deposits. It was constrained on

rates, and savings institutions could only give out so many toasters. Management had the loans to make and knew how to make prudent loans. The issue was how to get the depositor to fund those loans.

Then all of a sudden came rate deregulation and the regulators said, you as savings and loan managers can give any rate you want, which translated to limitless deposits. Unfortunately for FSLIC, some imprudent managers responded similarly to a five year-old child who for every week, had been given a nickel to go to the candy store to get anything he wanted. Suddenly, he was given \$5. but warned not to spend it all at once. not to gobble it all up at one time Under that scenario, you're bound and certain to have some sick kids who don't listen, and that's exactly what happened. Some people ate too much, rew too big, lost control and got one hell of a bellyache.

As the market discipline we championed began to work, however, we found that there were some very real costs involved. Non-performers or bad performers or misperformers could distort the market itself and change the market to slow or eliminate market discipline entirely; the industry could not absorb the losses that would have been entailed; and FSLIC simply could not pay the price to take these bad performers out of the marketplace.

What I want to focus on here. however, is another very serious mistake that we made as regulators. We failed to appreciate the impact of deregulation and free enterprise on the regulatory structure, and on the regulators themselves. As a form regulator, I confess I sort of liked going around the country pontificating on



what you had to do as managers, the challenges you had to face, the reorientation, re-education and rethinking you had to do. I must confess time would have been best served looking at what we as regulators were doing and not doing at the time. We failed to recognize that if you want less regulation, but you also want to maintain public confidence and to preserve a federally guaranteed insurance fund, you need adequate, well-trained, focused and responsive regulation and supervision. We were caught at the switches . . . and we got run over by the train.

I don't wish to demean any of my former staff or colleagues. To a pers the staff members of the Bank Board are dedicated, honest, sincere, and diligent individuals. They are fine human beings, and they are doing what they think is right. But we were overwhelmed by the rapidity of change. the growth of the industry and the scope of the challenge. Unfortunately, we didn't do much

cont. pg 12

The Death Of Discretion Or Growing Pains? (Cont. from pg. 11)

better under the Gray administration than we did under Chairman Pratt.

Truthfully, under the Gray administration, we wasted a year on brokered funds. Brokered funds were a device; they were not the illness. Our focus was, I think, misplaced. And though I was pleading for staff within 17 days of becoming Director of the Office of Examination and Supervision. there was no focus on the regulatory structure itself until Empire Savings of Mesquite collapsed. It is amazing the clarity of vision and understanding which comes once one is placed under the television lights in a hostile congressional committee. We suddenly realized we needed staff; that the regulatory structure itself had to change.

It was as if a Charge of the Light Brigade has occurred. I don't know if you've ever seen a true cavalry charge, but as all the horses are pounding there is an enormous cloud of dust. Maybe the guy at the very front has some vis on of what's happening, but everybody else is in the dust. And we had been talking a charge of deregulation, and less regulation. A charge forward letting people do their own thing. As our deregulation charge ot to the end of the valley and the dust settled, we looked up and discovered that the enemy was bigger than we were. The cavalry charge in retreat became one of re-regulation. Reregulation became chic. Enforcement was "in" and soon recapitalization became a goal for the industry, for the FSLIC, and for the Bank Board. But while everybody, including the Congress, the press, the industry, has talked about the capitalization of the industry and the recapitalization of FSLIC, very little attention has been

paid to the recapitalization of the Bank Board. The human recapitalization. The system which controls your institutions because it controls the regulations on underwriting and appraisals and everything else, all the hoops that have to be jumped through, is little a giant triangle. It consists of three parts. There, at the bottom of the triangle, are the examination and work-out people, examination being the field examiners, the work-out people being the FSLIC people that are actually out

there doing the nitry gritty. At the next level, the middle level of the triangle, are what I call supervision and negotiation, the supervisors and the deal doers. And at the top, of course, are the policy makers.

Let's talk about the bottom of the pyramid—the examiner or the worker bee level.

When I joined the FSLIC in 1982, there were a handful of people in the field. In fact, you could probably count them on both hands. Three hands would certainly have done it. Now with Federal Asset Disposition Association and the receivers in the field, the FSLIC staff is rapidly approaching 300 people in the field.

When I took over the Office of Examination and Supervision, we had about 700 examiners. In 1985, that function was transferred to the Banks. Now in July, 1986, there are 1,325 examiners. By year-end, there will be 1,500.

So, between FSLIC and the field examination force there are now 1,800 people in the field!

There are the workers, the fact

There are the workers, the fact finders, the work-out people, the initial human contact between the regulatory system and the industry. Who are these people? Where do they come from? What is their attitude? Who trains them? What philosophy are they being given? Does anybody know? Has the industry focused on that?

More importantly, let's go to the level which is supposed to exercise a significant amount of discretion, do negotiation, make decisions. This is the supervisory and negotiation level. The supervisory staff at the Federal Home Loan Banks has gone from 339 at the end of 1985, to 566 at the end of this year. The FSLIC government staff, which was 35 not too long ago and grew to 70 while Brent Bessley was there, is now 242 strong.

Moreover, the new Office of Regulatory Policy, Oversight and Supervision, or ORPOS, which is replacing OES has been privatized and we expect it to grow, perhaps double. The enforcement staff in Washington doubled this year and will increase by 50% next year. Who are these people? Where do they come from! What is their attitude! What do they believe about you! What is their contact with you! What kind of information are you providing them! This is a very

important issue. And I think it's something the leagues, the industry and you as managers have to think about. Regulations can be changed at the flick of an eye. I know, I've done it. But the attitude, training and indoctrination that these people receive in this new, emerging, huge structure will live with them for decades. The concern I have is, are we going to inbuse these people with an education and a mentality to understand the industry, to deal with the industry, and to have the professional guts to exercise discretion? Or are we going to imbue the system with the attitude of shoot first, ask questions later? Are we going to have these people focus on the bad players or is every institution going to set, a supervisory agreement for anything? Where and when is discretion to be allowed in the system?

When I was with the Justice Department in Chicago, I recall an incident at O'Hare. A gentleman by the name of Nixon was President and a lot of people didn't like him. He was to get on his airplane at the military side of O'Hare field and, somehow, about 35 demonstrators with some rather obscene signs, got on the field and were visible. Apparently what happened, was President Nixon turned to the gentleman beside him as they boarded Air Force One and said in a rather distracted and detached tone, "Who are those people and how did they get on the field!" After the plane took off, the gentleman to whom he had turned, a fellow by the name of Haldeman, got out of his seat, went to the front of the plane, sat down by another staffer. John Erlichman, and said, "John, the President was very upset. There were a lot of demonstrators on the field, we want to know what happened. Erlichman got out of his seat and called a guy by the name of Eagle Krogh in the White House. The conversation must have gone something like this: . . ." There was a large mob of demonstrators on the field, the President is furious, he wants to find out what happened." By the time the telephone call came to the U.S. Attorney's office, it sounded like the Fifth Army was going to have to go on

Right now, what's happening in the Bank Board is the same thing.

cont. pg. 18

Representative Dingle makes Ed Gray very uncomfortable. It's not nice to be told you fouled up. Chairman Gray turns to the Bank presidents and says. "If you want to keep your head, be tough!" The Bank president wants to keep his head and he turns to the supervisory agent and says, "Get your axes out, men, if anything's wrong, take action!" By the time it gets to the poor examiner in the field, Atilla the Hun just walked into your shop. That's not the system we want. With this many new examiners and supervisors, are we going to get into a world where we pick nits or are we going to get into a world where we focus on the real problems but are prepared with legitimate good management to work out problems? Are we just going to hit people with a meat hook? Think about that, because this structure is growing today and the industry needs to interface with it. These new people need to see the vast majority of you as honest, decent people who are doing a good job. Sure there are crooks out there, but they should not adopt an automatically negative attitude toward every manager.

That brings me to the last level of the triangle and one that has to be addressed. We have an "Acting School of Regulation" in Washington-they could give out academy awards. There's an Acting General Counsel, there's an Acting Deputy General Counsel there's an Acting Director of the Office of Policy and Economic Research, and there's an Acting Director of FSLIC There was an Acting Director of OES, but the Bank Board just hired a permanent replacement. The policy

level, the level that's bringing all these people in and training them, has got to become more solidified. Direction has to be given, senior people have to be hired, and these new people have to be"

I guess my message to you, having been a regulator, is that as this system grows, it is incumbent upon you to watch it. To be aware that it's growing, to be aware that a huge number of people will be interfacing with you who are new, and that they need to be educated by the industry, and I think

the industry can play a hig role in that. The system is so large now the Bank Board has its own university. A lot of people don't know that. It is the Federal Home Loan Bank Board stem Office of Education in Dallas. fully staffed, with a former dean of a business school heading it up. The industry itself, however, ought to be offering to put on its own courses to othering to put on its own courses to help educate these people on the good sides and the history of the industry.

The industry should be observant and involved as the human capital of the Bank Board is reconstituted.

FSLIC will be recapitalized, and I'm confident that over time the industry will recapitalize itself, but don't forget that new human capital of our ... regulatory structure, because you are going to live with it the next 10 to 10 vears.

League's Eastern Secondary Mortgage
Market Conference in Raleigh. Schilling is an attorney in Las Angeles, California.

APPENDIX - C

CASE EXAMPLE #1

A well-managed Kansas institution with consistent profit, GAAP net worth in excess of 5%, established loan loss reserves in excess of requirements, and scheduled items well below the national average was recently (February 20) advised:

- Write down a condominium project upon which the association had <u>already</u> established a loss reserve using GAAP accounting.
- 2. Directed to secure an R-41c appraisal.....at a cost of \$6 to \$8 thousand dollars.....on a project that was 85% leased and had a positive cash flow. This R-41c request was made after the recent District Court case and one week after the PSA had supposedly halted the "near automatic" directives for R-41c appraisals.
- Raised the possibility of a conflict-of-interest pertaining to an affiliate company when this issue had been addressed and approved by both the Regional FHLBank and the FMLBB at the time of acquisition three years ago.

The same association had earlier been directed by the supervisory agent to write off as a \underline{loss} a \$495,000 project. Two weeks later the institution received \$245,000 in cash, a summary judgment, and title to the land.

APPENDIX D-1

CASE EXAMPLE #2

Three Kansas associations entered into a participation on a land development project in Texas (Dallas area) in 1984. association has a \$1.6 million participation exposure in the project originally funded at \$28.3 million by some 12 lenders. The original appraisal was \$42 million.

The following is the chronology of events:

March, 1986: Kansas Lender A examined by FHLBank of Topeka with concern expressed regarding the project

since it was in Texas.

Summer, 1986

New York Lender A, a participant, ordered R-41c appraisal by an MAI to ascertain present value. Appraisal completed by September 6 with other participants sharing in the cost. The MAI appraisal established value at \$27.3M. Kansas participants prepare to establish loan loss reserve for pro-rata share of the \$1 million.

September, 1986: Kansas Lender A advised by FHLBank of Topeka that they should seek MAI appraisal on the

Lender A advised the Bank of the just completed appraisal and sent a copy to the

Topeka Bank.

September, 1986: Texas Lender A advised by Dallas Bank of the

need for appraisal. Recently completed appraisal was sent to Dallas bank. No indication of

further action.

Kansas Lender A was advised by the Topeka December, 1986:

FHLBank that the Bank had ordered a new apprai-

sal on the project.

Kansas Lender A, B and C were advised by the FHLBank of Topeka that the MAI appraisal had February, 1987:

been completed and a value on the project established at \$18.5 M. Each association was directed to establish pro-rata loan reserves as

of March 1 and to share in the cost of the

appraisal.

Question: How can two MAI appraisals completed by

reputable firms, using R-41c, vary by nearly \$10 million dollars in a three month period and resulting in an immediate half-million dollar "hit" to the net worth of three Kansas as-

sociations occur?

The engagement letter of the FHLBank dictates a Answer:

"low ball" appraisal.

Reason: Classic CYA. Chinese proverb dictates that

when you suspect three bad guys in a crowd of 100 the best way to ascertain that you have eliminated the three bad buys is to shoot all

100!





DEPARTMENT OF EXAMINATIONS

December 1, 1986

Mr. Kelly W. Miller, MAI Vice President

Arlington, Texas 75222

RE: Business Center

Mixed Use Development

Arlington, Texas

Dear Mr. Miller:

To confirm your recent telephone discussions with Alex Morar, Jr., of this office, this letter will constitute your assignment to appraise the Business Center land located in Arlington, Texas, which is further identified by the enclosed site plan and legal description. This assignment is initiated in conjunction with our current examination of

According to our met recent information, the reputed owner of the subject property is

A copy of my letter is enclosed to its President and Managing Officer requesting him to furnish whatever data you may require.

The purpose of this appraisal is to estimate market value as of your appraisal date, which shall be the date of your last inspection of the subject property. Market value, for our purpose, is defined in FHLBB Memorandum R 41c (attached). Although the appraisal report must meet the requirements of R 41c in all respects, we invite your special attention to the market/economic feasibility and discounting aspects of this memorandum.

2 TOWNSITE PLAZA / SUITE 130 P.O. BOX H2B / TOPEKA, KANSAS 66601 Mr. Miller

'- 2 -

December 1, 1986

We require thirteen (13) copies of the complete narrative appraisal report which meets all of the requirements of R 41c together with any professional appraisal standards not covered therein. We understand that your fee for this appraisal will be \$8,920 and that you propose to mail the report in approximately 30 days. Please advise this office promptly if you encounter any appreciable deviation from that schedule, or if you have any questions about the assignment.

The report and the statement for your services should be addressed to the FHLB of Topeka as shown on this letterhead, and mailed to this office for distribution.

Yours truly,

Gold Collins

John S. Collins
Director of Examinations

Attachments

cc: Supervisory Agent's and Directors of Examinations Districts 2, 6, 8, 9, 10

rield Manager

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JSC:dkh

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS NINETY-NINTH CONGRESS WASHINGTON, DC 20515

February 24, 1987

Mr. Wade T. Nowlin Chairman of the Board and Chief Executive Officer Nowlin Savings & Nowlin Mortgage Co. 9001 Airport Freeway Ft. Worth, TX 76180

Dear Mr. Nowlin:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as a chief executive officer of a savings and loan association and mortgage company will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's jurisdiction. More particularly, frequent charges of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as a savings and loan association executive, we would appreciate having the benefit of your experience and your comments on how to preserve regulatory independence while at the same time insuring basic elemental due process for those impacted by regulatory adverse actions.

In accordance with committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record and, if delivered when requested, the statement will be made available to all subcommittee members in advance of the hearing. Due to the large number of witnesses, we request that your oral summary statement be preferably five minutes in length but not to exceed ten minutes to permit all members sufficient time for questioning.

June 9 th June Fernand J. St Germain Chairman

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NIMETY-MINTH CONGRESS
WASHINGTON, DC 20515

February 24, 1987

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Mr. Arthur S. Berner General Counsel United Savings Association of Texas 5718 Westheimer Houston, TX 77057

Dear Mr. Berner:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as the General Counsel of the largest savings and loan association in Texas will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's jurisdiction. More particularly, frequent charges of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as a savings and loan association executive, we would appreciate having the benefit of your experience and your comments on how to preserve regulatory independence while at the same time insuring basic elemental due process for those impacted by regulatory adverse actions.

In accordance with committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record and, if delivered when requested, the statement will be made available to all subcommittee members in advance of the hearing. Due to the large number of witnesses, we request that your oral summary statement be preferably five minutes in length but not to exceed ten minutes to permit all members sufficient time for questioning.

Mcerely,

Fernand . St Germain

Chairman

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
INNETY-WINTH CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20615-8051

February 24, 1987

CHALMER P WYLE GRO IN LECCY LOWA STRINGER E SELEMENT, COURSE SCHILLER PLOTENT, CALPO BELLEC CHARTER, CALPO BENNE DESERT, CALPOTEN STAR PARISE, VIDENTIA STAR PARISE, VIDENTIA BOULESIA, REV JORGE BOULESIA, REV JORGE STAY BANKETT TOKAS STRYE BANKETT TOKAS

Mr. W. Drew Darby, Esquire 15770 Dallas Parkway Suite 900 Dallas, TX 75248

Dear Mr. Darby:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as an attorney for a number of west Texas lenders and your knowledge of the portfolio of the San Angelo Savings and Loan Association will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's jurisdiction. More particularly, frequent charges of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as one thoroughly familiar with savings and loan associations, we would appreciate having the benefit of your experience and your comments on how to preserve regulatory independence while at the same time insuring basic elemental due process for those impacted by regulatory adverse actions.

In accordance with committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record and, if delivered when requested, the statement will be made available to all subcommittee members in advance of the hearing. Due to the large number of witnesses, we request that your oral summary statement be preferably five minutes in length but not to exceed ten minutes to permit all members sufficient time for questioning.

Sincerely,

Fernand J. St Germain

Chairman

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COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NIMETY-MINTH CONGRESS
WASHINGTON, DC 20815

February 24, 1987

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Mr. Scott Hudson 3626 North Hall Street #906 Dallas, TX 75219

Dear Mr. Hudson:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as a former owner of a number of savings and loan associations and commercial banks, as well as that of a former prosecutor, will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's jurisdiction. More particularly, frequent charges of "arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as one thoroughly familiar with savings and loan associations, we would appreciate having the benefit of your experience and your comments on how to preserve regulatory independence while at the same time insuring basic elemental due process for those impacted by regulatory adverse actions.

In accordance with committee rules, please deliver 175 copies of your prepared statement to Room B303 Rayburn House Office Building, Washington, DC 20515, 24 hours in advance of your scheduled appearance. Your statement in its entirety will be included in the hearing record and, if delivered when requested, the statement will be made available to all subcommittee members in advance of the hearing. Due to the large number of witnesses, we request that your oral summary statement be preferably five minutes in length but not to exceed ten minutes to permit all members sufficient time for questioning. questioning.

Sincerely,

fornand J. St Germain Chairman

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS NINETY-HINTH CONGRESS WASHINGTON, DC 20515

February 24, 1987

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Mr. Jim Fogleman Chairman of the Board and Chief Executive Officer Louisiana Savings Association 901 Lakeshore Drive Lake Charles, LA 70602

Dear Mr. Fogleman:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

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Sincerely,

formand J. St Germain Chairman

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS NINETY-WITH CONGRESS WASHINGTON, DC 20818

February 24, 1987

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Mr. Don D. Guidry Chief Executive Officer LaFayette Building Association 107 West Vermillion Street LaFayette, LA 70501

Dear Mr. Guidry:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as a chief executive officer of a savings and loan association will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

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Sincerely,

Sund Jay Juman Fernand J. St Germain Chairman

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20618-6061

February 24, 1987

PULLISHE P WYLE, ONE SELLECT STAN TOWNST & SECURISTY, CONSISTIOUT STANS & SHARMAY, CALIFORNIA BLINGCOLLINE, ROSHEA BONGE C WORKLEY HOW YORK WIND DIRECK, CALIFORNIA TAN ANDRE, WISHAM MARGE SOLUTION, NEW ADMETY GUES BOSTATES, HISHARIA THYS BANTLEY, TOLKS

Mr. Donald F. Roby President and Chief Executive Officer Farm & Home Savings Association 221 W. Cherry Nevada, MO 64772

Dear Mr. Roby:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27 and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

n add tion to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, ntroduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as a chief executive officer of a savings and loan association and as the former President of the Federal Home Loan Bank of Des Moines will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stabil ty of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

You are also, I believe, aware of the fact that statements have appeared regarding the manner and means in which individual home loan banks and their respective supervisory agents have discharged their responsibilities toward a number of associations within each bank's 'urisdiction. More particularly frequent charges of arbitrary and capricious" actions by examiners and supervisory personnel have been made and continue to be made. From your perspective, again, as a savings and loan assoc ation executive and former regulator, we would apprec ate having the benefit of your experience and your comments on how to preserve regulatory independence while at the same time insuring basic elemental due process for those impacted by regulatory adverse actions.

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Sincerely,

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U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS INNETY-WINTH CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20615-8061

February 24, 1987

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SITAR FARRE, VIRGINIA
MARIE ROUTER, NEW JARREY
SOULE SERVITER, NEW JARREY
SOULE SERVITER, MEMARIKA
STYM SAMTUT, TOMAR

Mr. Nolan L. Rumbley Executive Vice President American Federal Savings 601 Grand Avenue Des Moines, IA 50307

Dear Mr. Rumbley:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as an executive vice president of a savings and loan association will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

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Sincerely,

Fernand J. St Germain Chairman

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JARROL HUBBARD, JR. TERTUCK DOUG SANARO, JR. GEORGIA JOHN J. LJALCE REW YORK MARY TORE OLARA OHIO BRUCE I YURTO MINISTORY BRUCE I YURTO MINISTORY CHARLES E. SCHUMER REW YORK SANIEY FRANK MASSACHUSTER MICHAEL SCHUMER SEED SUCY ROSING LUBBARD BUCH ROSING LUBBARD BUCH ROSING LUBBARD BUCH ROSING LUBBARD BULL RESIDER, ROSING BULL RESIDER, ROSING BULL RESIDER, ROSING BULL RESIDER, ROSING

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS NINETY-NINTH CONGRESS

ROOM 8-303 RAYBURN HOUSE OFFICE BUILDING WASHINGTON, DC 20515-8051

February 24, 1987

Mr. James R. Turner President Kansas League of Savings Institutions Suite 612 700 Kansas Avenue Topeka, KS 66603

Dear Mr. Turner:

Reference is made to staff discussions concerning subcommittee hearings on March 3 and 4 on the provisions of the Federal Savings and Loan Insurance Corporation Recapitalization bill, H.R. 27, and related issues. The Subcommittee would appreciate your appearance on March 4, 1987, at 10:30 a.m. in Room 2128 Rayburn House Office Building.

In addition to your comments on the provisions of H.R. 27, we would also ask for your views on the provisions of H.R. 1063, introduced by Congressman Bartlett and co-sponsored by three other members of the Committee. Your experience as the President of the Kansas League of Savings Institutions will be invaluable. Any suggestions that you may care to submit of an amendatory nature will, of course, be appreciated as we endeavor to provide assistance to FSLIC and, hence, assist in maintaining stability of the thrift industry while preserving public confidence in the safety and soundness of our institutions and the government's ability to react.

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fund of guain Fernand J. St Germain Chairman

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Enclosures

A CALLED



March 11, 1987

Mr. Gary Bowers, Deputy Staff Director Subcommittee on Financial Institutions Supervision, Regulation and Insurance Room # B 303 Rayburn House Office Bldg. Washington, D. C. 20515



Dear Mr. Bowers:

Currently before the House of Representatives is the issue of FSLIC recapitalization and regulatory forebearance for $\frac{\text{well-managed}}{\text{managed}}$ savings and loan associations in economically depressed regions.

I would urge the Subcommittee to mark-up a plan that specifically includes the use of amortization for loan losses. This is <u>vital</u> to the savings and loan industry.

The current <u>depth</u> of the economic recession in Texas and other areas has deteriorated our net worth drastically. Allowing the FHLB (Federal Home Loan Bank) to implement a "dubious" forebearance policy as proposed by Chairman Edwin Gray could really be no forebearance at all.

I estimate that even with <u>selective</u> use of FASB 15, as restructed by Mr. Gray's eligibility requirements, the relief provided would be so limited as to do little good. A hypothetical comparison of the use of FASB 15 versus <u>amortization of loan loss indicated</u> that FASB 15 would be about <u>60X - 70X as effective</u>, when finally authorized.

It should also be pointed out that net worth forebearance only would create serious doubt in the mind of our savings customers when reviewing an association's statement of financial condition. Disintermediation (loss of savings accounts) would occur.

Various proposals have been submitted. While each has some merit, I would <u>strongly</u> recommend the two-part plan presented by the U.S. League of Savings Institutions Task Force on FSLIC Issues. The reasons include:

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 The FSLIC recapitalization plan would, over the next twenty (20) years, be far cheaper than the Treasury Bank Board proposal for our industry as a whole.

Treasury Undersecretary George Gould has testified that the \$5 billion a year recapitalization plan outlined by the U. S. League of Savings Institutions Task Froce on FSLIC issues would be sufficient. It, of course, would certainly be proper for the Treasury and Bank Board to come back to Congress in two (2) years and prove the case for additional funding.

The U. S. League plan does \underline{not} require any taxpayers' money. All the money comes from savings institutions.

2. Due to the severity of economic recession in Texas, as well as, other regional areas affected by declines in the oil, farming, and timber industries, we frankly need some forebearance in order for well-managed institutions to survive. A forebearance approach would allow savings institutions "breathing space" to recover as our economies recover, thereby alleviating additional pressures on the already beleaguered FSLIC. Savings and Loan Associations are currently required to contribute ever increasing amounts of capital in the form of FSLIC "special assessment" premiums, and many are also required to further inject capital, in the form of net worth, which they simply do not have at this time.

More specifically, the U. S. League's two-part program would allow well-managed savings and loan associations in economically depressed regions the following:

- Forebearance from increasing net worth requirements until such time as our economy recovers.
- 2. Use of General Accepted Accounting Principles (GAAP) which permit use of (FASB 15) relating to restructuring of troubled debt. This principle has been used and is being used by the Comtroller of the Currency to assist banks in similar economically depressed regions. It too is a temporary measure.
- Relief from Federal Home Loan Bank (FHLB) requirements of Appraisal Memorandum R-41c, which affects asset carrying values for existing assets.
- 4. Relief from a FHLB policy of "double jeopardy" regarding their ability to both schedule items and classify assets as substandard, doubtful, or loss or both at the same time. this has a double negative affect on our net worth.

page 3

All of these measures are <u>temporary</u> in nature and necessary in order to allow us time to survive during the severe recession being experienced.

I urge your strong and immediate support.

Sincerely,

Paul Price President

PP/c1



February 17, 1987

The Honorable Fernand J. St. Germain U. S. House of Representatives Room 2108 Rayburn House Office Building Washington, D.C. 20515

Re: FSLIC Recapitalization

Dear Congressman St. Germain:

I am taking the liberty to notify you of my feelings concerning the recapitalization of the Federal Savings and Loan Insurance Corporation.

When I compare the U. S. League plan with that of the Treasury plan for recapitalization of FSLIC, I come to the conclusion that the U. S. League plan and recommendation is the one that I would support and would suggest that you support. I submit the following points in this consideration:

- (1) The healthy portion of the savings institutions business is stepping forward to finance the recapitalization of the insurance fund, without looking to the taxpayers. This self-help initiative is unprecedented. But the business should not be asked to write a blank check on its capital and future earnings.
- (2) The Treasury/Bank Board plan includes far too much borrowing, with a resulting unnecessary debt service burden on the business. A two-year, \$5 billion bonding program, together with the regular premium and a phased down special assessment, will raise a similar amount to that in the Treasury/Bank Board plan for resolving the most urgent cases over the coming two years. The \$10 billion made available to the FSLIC in the next two years will allow the agency to spend in those two years about three times the largest amount ever spent in a single year. At that point, Congress can review the situation and decide whether more is needed. If so, the League approach allows the flexibility to raise more funds.
- (3) A sensible way to reduce the cash demand on FSLIC is to buy time for well-managed institutions in economically depressed areas. This can be accomplished by a carefully managed regulatory and

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The Honorable St. Germain February 17, 1987 Page 2

> supervisory forebearance program. Given time to recover, along with the economies of their regions, these institutions may never have to be added to the caseload requiring FSLIC cash outlays.

Your support will be appreciated.

Sincerely,

FIRST AMERICAN FEDERAL SAVINGS & LOAN ASSOCIATION

Chairman of the Board & CEO

/mb

AKIN, GUMP, STRAUSS, HAUER & FELD

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March 16, 1987

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VIA HAND DELIVERY

Ms. Ann Kline
Committee on Banking, Finance and
Urban Affairs
Financial Institutions Supervision,
Regulation and Insurance Subcommittee
B303 Rayburn House Office Building
Washington, D.C. 20515

RECEIVED

Subcommittee on Financial Institutions

MAR 16 1987

Dear Ms. Kline:

On behalf of the First Texas Savings Association, enclosed is the promised letter to be inserted in the record of hearings held on March 3 and 4, 1987, by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance on FSLIC recapitalization.

Please call Marydale DeBor or me if you have any questions.

Sincerely,

Smith W. Davis Marydale DeBor Janet Z. Barsy

Enclosure



J. Michael Cornuali Chairman and Chief Francisc Officer

March 16, 1987

The Honorable Fernand J. St. Germain U.S. House of Representatives Chairman, Committee on Banking, Finance and Urban Affairs Washington, D.C. 20510

Dear Mr. Chairman:

The First Texas Savings Association applicates the efforts of your Committee to identify solutions for abating the rapidly worsening condition of thrift institutions, and wishes to take this opportunity to make the following observations and suggestions for your consideration.

As you know, the current S&L crisis in the Southwest, as well as other geographic areas, has been largely precipitated by a downturn in real estate values due to macroeconomic factors beyond the control of the real estate and banking industries affecting the energy and agricultural sectors, such as the drastic decline in the price of oil and other commodities. The best financial managers are among those now faced with unique problems that will only respond to bold initiatives that bring together the talents and resources available in both private industry and government.

The Federal Home Loan Bank Board has taken a step in the right direction with the announcement on February 26, 1987 of its formal policy on forbearance "toward well-run savings institutions experiencing temporary financial difficulties due to distressed regional economies." However, it is clear that forbearance measures will not be adequate to deal with the magnitude of specialized problems now confronting the S&L industry. The Bank Board's policy will not be enough to cure the problems being experienced by even "well run" institutions, and almost certainly will leave behind struggling institutions that might have a good chance at survival and future economic growth if there were the proper stimulus.

First Texas Tower • 14961 Dalles Parkway • Dalles, Texas 75240 • (214) 980-4661

Page two

Representative Steve Bartlett's bill, the "Thrift Forbearance and Supervisory Reforms Act," contains some useful initiatives, including the requirement that the federal government embark on a comprehensive study (to be followed by specific proposals) of the feasibility of an asset acquisition corporation. Such a corporation, for example, could be managed and capitalized by private or public funding, or a mixture of both, and could serve as a "warehouse" facility for nonperforming acquisition, development and construction loans and non-earning real estate owned to relieve S&Ls from carrying nonperforming assets. In exchange, the S&Ls would receive some form of debt instrument issued by the corporation.

We believe that the concept of "warehousing" nonperforming real estate loans and REO deserves careful analysis. "Warehousing" may provide S&Ls burdened with such nonperforming assets the time necessary to allow those assets to regain their inherent value without being written down in the interim. The best estimates are that the downturn in real estate is temporary, but that recovery still is five to ten years away. Even well-managed S&Ls need time to restructure their portfolios and to hold on to projects which would become viable in the future after an economic turnaround.

To this end, both private and government resources may offer the most effective way to give essentially well-run S&Ls the ability to withstand the temporary downturn in regional economies. A transition funding mechanism which would convert nonperforming loans to income producing assets could meet the needs of troubled institutions.

Page three

Right now there is sentiment in the Congress to pass, agis at on that will hunriedly infuse funds into the Federal Savings and worn insurance. Corporation to put the industry on a course of necovery. Incorporating a study and eventually implementation of an asset acquisition corporation is an essential ingredient of any program designed to neturn the thrift industry to strengthened profitability.

We urge your Committee to endorse the concept of Representative Bartlett's study of the feasibility of establishing an asset acculation corporation as discussed above, and we would be pleased to work with you on this important matter.

Sincerely,

J. Michael Cornwall

Chairman and Chief Executive Officer

J. Michael Commodel

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